APPENDIX A

UNITED STATES COURT OF APPEALS,
DISTRICT OF COLUMBIA CIRCUIT

NOS. 99-1020, 99-1051, 00-1221, 00-1240, 00-1256, 01-1413, 01-1453, 01-1469, 01-1475, 02-1008, 02-1011, 02-1321

BP WEST COAST PRODUCTS, LLC,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION AND UNITED STATES OF AMERICA,
Respondents.

SFPP, L.P., ET AL.,
Intervenors.

Argued Nov. 12, 2003.
Decided July 20, 2004.

Before: SENTELLE, ROGERS, and ROBERTS, *Circuit Judges*.

Opinion for the Court filed PER CURIAM.

INTRODUCTION

The consolidated petitions before us seek review of four opinions of the Federal Energy Regulatory Commission ("FERC" or "the Commission"):

1. *SFPP, L.P.*, Opinion No. 435, 86 FERC ¶ 61,022, 1999 WL 12216 (1999) ("Opinion No. 435");

2. *SFPP, L.P.*, Opinion No. 435-A, 91 FERC ¶ 61,135, 2000 WL 640584 (2000) ("Opinion No. 435-A");

3. *SFPP, L.P.*, Opinion No. 435-B, 96 FERC ¶ 61,281, 2001 WL 34076552 (2000) ("Opinion No. 435-B"); and

4. *SFPP, L.P.*, 97 FERC ¶ 61,138, 2001 WL 1379466 (2001) ("Clarification and Rehearing Order").

In these opinions FERC considered the tariffs of SFPP, L.P., and complaints and other filings by shipper customers of SFPP. SFPP, L.P., both a petitioner and an intervenor-respondent in the consolidated dockets, operates pipelines that transport petroleum products in Texas, New Mexico, Arizona, California, Nevada, and Oregon. SFPP's operation includes a West Line and an East Line. The West Line consists of pipelines extending from Watson Station in Los Angeles, California, into Arizona to Phoenix and Tucson, and connects at Colton, California, with another pipeline system extending to Las Vegas. SFPP's East Line consists of pipelines from El Paso, Texas to Tucson and Phoenix. The orders under review consider, set, and otherwise govern rates on both lines. We consider three separate sets of petitions: the petition of SFPP, L.P.; the petition of the West Line Shippers ("WLS"); and the petition of the East Line Shippers ("ELS"). Petitioners and Intervenors include the following: BP West Coast Products LLC ("BP WCP"; formerly ARCO Products Company); Chevron Products Company ("Chevron"; including the former Texaco Refining and Marketing, Inc.); ConocoPhillips Company ("ConocoPhillips"); ExxonMobil Oil Corporation ("ExxonMobil"; formerly Mobil Oil Corporation); Navajo Refining Company, L.P. ("Navajo"); Western Refining Company, L.P. ("Western"); Ultramar Inc. ("Ultramar"); Valero Energy Corporation ("VEC"); Valero Marketing and Supply Company ("Valero"); and SFPP, L.P. ("SFPP").

The administrative proceedings before FERC began with tariff filings by SFPP for both East and West Lines. The lengthy, complex, and convoluted proceedings that followed included complaints and/or protests filed by shippers on the

two lines, as well as investigation into SFPP's tariff filings by FERC's Oil Pipeline Board. The issues are further complicated by novelty in that this is the first oil pipeline case in which the "changed circumstances" standard of the Energy Policy Act of 1992 ("EPAct") has arisen for litigation. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (codified as 42 U.S.C. §§ 1320-556 (2003). While we will not detail the administrative proceedings before FERC's administrative law judge and the full Commission as we discuss them at length in the analyses that follow, we note that issues presented for review include, among other things, the important question of application of the grandfathering principle under the new EPAct, the allocation of litigation costs between the East and West Lines, tax pass-through problems involving non-taxed subsidiaries of taxable entities, the payment of reparations after a finding of unjust or unreasonable rates, and the correct determination of capital structure to determine a starting rate base. The reader is duly warned.

For reasons set forth more fully below, we are able to affirm many of FERC's answers to specific issues, but because we find error in several fundamental areas, we order the decisions under review vacated and remand the matter for further proceedings consistent with this opinion.

I. The West Line

A. *Grandfathering of Rates under the EPAct*

Section 1803 of the EPAct limits the ability of shippers to challenge pipeline rates in effect at the time of the enactment of the EPAct. Section 1803 provides that any oil pipeline rate that was "in effect" for a full year before the EPAct's enactment on October 24, 1992, and was not subject to "protest, investigation, or complaint" during that 365-day period, is "deemed to be just and reasonable." EPAct § 1803(a)(1).

These "grandfathered" rates are categorically immune from challenge in a complaint proceeding under Section 13 of the Interstate Commerce Act ("ICA"), 49 U.S.C. app. § 13(1) (1988) (repealed),[1] except when:

> (1) evidence is presented to the Commission which establishes that a substantial change has occurred after the date of the enactment of this Act—
>
> (A) in the economic circumstances of the oil pipeline which were a basis for the rate; or
>
> (B) in the nature of the services provided which were a basis for the rate; or
>
> (2) the person filing the complaint was under a contractual prohibition against the filing of a complaint which was in effect on the date of enactment of this Act . . . .

Id. § 1803(b). In the post-EPAct world, the analysis of a pipeline rate challenge thus proceeds in two steps: first, FERC determines whether the rate in question is grandfathered; if it is, FERC then asks whether the rate falls within either of the exceptions outlined in Section 1803(b). The Commission may not alter a grandfathered rate that does not fall within an exception.

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[1] Although the ICA was repealed in 1978, *see* Pub. L. No. 95-473 § 4(b), (c), 92 Stat. 1466, 1470 (Oct. 17, 1978), FERC has "the duties and powers related to the establishment of a rate or charge for the transportation of oil by pipeline or the valuation of that pipeline that were vested on October 1, 1977, in the Interstate Commerce Commission." 49 U.S.C. § 60502 (2003). The relevant version of the ICA was, but is no longer, reprinted in the appendix to title 49 of the United States Code. Therefore, when we refer to FERC's authority under the ICA, we cite to the 1988 edition of the U.S. Code, the last such edition that reprinted the ICA as it appeared in 1977.

B. *Grandfathering of West Line Rates*

The WLS contend that none of the West Line rates are grandfathered, and further argue that even if the rates are grandfathered, their challenges fall within the exceptions set out in Section 1803(b). We examine each of these contentions in turn.

1. *Rate "In Effect" for One Year*

To be eligible for grandfathering, a pipeline rate must have been "in effect for the 365-day period ending on the date of the enactment of this Act [October 24, 1992]." EPAct § 1803(a)(1). Thus, to be grandfathered, a rate must have been "in effect" on October 25, 1991, and have remained in effect at least until the enactment of the EPAct.

The WLS do not contest this element with regard to the bulk of the West Line rates. Nor could they; the West Line rates became effective in 1989 pursuant to a settlement terminating a 1985 rate proceeding. *See* Opinion No. 435, 86 FERC at 61,057; *Southern Pac. Pipe Lines, Inc.*, 45 FERC ¶ 61,242 (1988) (order approving settlement). The WLS do, however, challenge the eligibility for grandfathering of certain improvements to the West Line made after October 1991.

a. *East Hynes Origination Point*

In July 1992, SFPP made revisions to its Tariffs Nos. 15, 16, and 17 to add a new origination point on its West Line—the East Hynes station in Los Angeles County, California—and to add a rate for shipping services from that new origination point to Arizona. The rate came into effect in October 1992. The rate, however, was not new; it was the same as the rates from SFPP's two other source points in the Los Angeles area. Examining this situation, the Commission concluded that the rates from the East Hynes station qualified for grandfathering because the July 1992 "filing did not

involve a change to a rate or service SFPP was providing at the time the EPAct was enacted." Opinion No. 435, 86 FERC at 61,063. SFPP's revision to its tariffs "only added another tap within an existing rate cluster . . . . No rate . . . was changed, and there was no change in the products transported or the services provided." *Id.*

The question essentially boils down to the Commission's interpretation of the term "rate" in Section 1803. As this is the first case to be litigated under the new standards of the EPAct, we must consider the level of deference—if any—to which FERC's interpretations of the EPAct are entitled. It is true, as some petitioners have noted, that the EPAct does not expressly confer rulemaking authority on the Commission. Section 1803 of the EPAct does, though, clearly contemplate that the Commission will enforce the terms and conditions of the statute through formal adjudications. *See* EPAct § 1803(b) (referencing "proceeding instituted as a result of a complaint"). When Congress authorizes an agency to adjudicate complaints arising under a statute, the agency's interpretations of that statute announced in the adjudications are generally entitled to *Chevron* deference. *See United States v. Mead Corp.*, 533 U.S. 218, 229 (2001) ("[A] very good indicator of delegation meriting Chevron treatment [is] express congressional authorizations to engage in the process of rulemaking or adjudication that produces regulations or rulings for which deference is claimed."); *see also Trans Union Corp. v. FTC*, 81 F.3d 228, 230 (D.C. Cir. 1996) ("[W]e have expressly held that *Chevron* deference extends to interpretations reached in adjudications as much as to ones reached in a rulemaking." (citing *Midtec Paper Corp. v. United States*, 857 F.2d 1487, 1497 (D.C. Cir. 1988))). We see no reason to accord any less deference to FERC's interpretations of the EPAct.

Under the familiar *Chevron* two-part inquiry, we first ask whether Congress has directly spoken to "the precise question

at issue." *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842 (1984). If it has, that is the end of the inquiry; we "must give effect to the unambiguously expressed intent of Congress." *Id.* at 843. If Congress has not spoken so precisely, though, we reach the second step, and will defer to any reasonable interpretation of the statute by the agency. *Id.* Not surprisingly, Congress did not have occasion to confront the specific question of whether the addition of a new source point on an existing rate cluster would constitute a new rate. We thus proceed to the second step of *Chevron*, and inquire whether the Commission's construction is a reasonable one. It is. It is certainly permissible to conclude that the addition of a tap to an existing rate structure, completed without any change in the existing shipping rates, does not constitute a new rate. To employ an analogy that we find helpful, in adding the East Hynes station to its West Line, SFPP merely added an on-ramp to its existing expressway. We think that the Commission's conclusion reflects a permissible interpretation of the statute and thus affirm its holding that the rate for shipping from East Hynes is eligible for grandfathering.

b. *Watson Station Enhancement Facility*

Watson is the primary origin point for West Line shipments to Phoenix and Tucson. In 1989, SFPP notified its shippers that, starting in 1991, the minimum pumping rate and pressure from Watson Station would increase. SFPP gave its shippers the option of providing their own pressurization facilities by a date certain, or using, for a surcharge, a facility built by SFPP. By late 1991, most of SFPP's shippers had contracted to use SFPP's new enhancement facility, and on November 1, 1991, SFPP initiated the enhancement services. *See* Opinion No. 435, 86 FERC at 61,074; *In re SFPP, L.P.*, 80 FERC ¶ 63,014, 65,156 & n. 405 (1997) ("ALJ Decision"). SFPP, though, never filed those contracts with the Commission, because it believed its

enhancement services were beyond the reach of FERC's jurisdiction. *See* Opinion No. 435, 86 FERC at 61,074. The Commission, however, concluded otherwise and ordered SFPP "to file a rate equal to the historic charge in the shipper contracts." *Id.* at 61,076.

Despite FERC's concession that "Section 1803 only addresses rates that were on file with the Commission," Opinion No. 435-A, 91 FERC at 61,502, and its acknowledgment that the enhancement rates had never before been filed, FERC nevertheless concluded that, because "the charges for the Watson Station facilities are part of enforceable contracts," the rates were "the equivalent of a lawful, effective rate." Opinion No. 435, 86 FERC at 61,076. The Commission reasoned that because all the Watson enhancement rate contract charges "were in effect before October 24, 1992," the shippers challenging those charges had to establish "substantially changed circumstances." *Id.* at 61,075, 61,076. The fact that no statute permitted a shipper to challenge an unfiled rate before the Commission did not matter. For "if [the rates] had been filed . . ., it is clear that they would have been grandfathered because there was no challenge to them during the 12 months proceeding [sic] the enactment of the Act." Opinion No. 435-A, 91 FERC at 61,502.

We find the Commission's reasoning on this point to be fundamentally flawed, and vacate this portion of its order. First, if FERC is indeed correct in its interpretation that Section 1803 applies only to filed rates, the Commission may not grandfather unfiled rates on the assumption that if the rates had been filed, no challenge would have been brought. The Commission may not regulate rates as if they existed in a world that never was. It must take the rates as it finds them, and here, FERC found them unfiled. If FERC interprets Section 1803 to apply only to filed rates, then it may not extend the benefits of that provision to unfiled rates based on

speculation about what would have happened had they in fact been filed. Invoking the so-called "filed rate" doctrine—which "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority," *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981)—the WLS argue that the pipeline's failure to file a Watson enhancement rate tariff with the Commission precludes the Commission's treatment of the unfiled rate as grandfathered. Our disposition of this issue—which is based on the Commission's flawed reasoning, and not a flawed conclusion—does not require us to decide definitively whether Section 1803 of the EPAct applies only to filed rates.

Second, Opinion No. 435 suggests that any rate agreed upon before the EPAct's enactment on October 24, 1992 could be grandfathered. *See* Opinion No. 435, 86 FERC at 61,075 ("The clear purpose of the EPAct's grandfathering provisions is to insulate pipelines from challenges to . . . rates . . . if those charges were in effect before October 24, 1992."). Section 1803, though, allows grandfathering of only those rates that were in effect (and unchallenged) for at least 365 days prior to the date of enactment of EPAct. EPAct § 1803(a). Even if we assume as a general proposition that Section 1803 applies to unfiled rates, other statements sprinkled throughout Opinion No. 435 suggesting that some of the rates were contracted for after the 365-day window had closed would remain problematic. *See* Opinion No. 435, 86 FERC at 61,075 ("the contracts were entered into voluntarily by the parties, mostly before the end of 1991"); *id.* ("all the relevant contracts were required to be, and had been, executed well before June 1, 1992"). If the Commission allows Section 1803 to apply to unfiled rates, those rates, to be grandfathered, must be in effect for at least 365 days prior to the EPAct's enactment. The reasoning of Opinion No. 435 gives us no comfort that this was the case. Without such an

assurance, we cannot affirm the Commission's conclusion that the Watson enhancement rate is subject to grandfathering.

c. *Turbine Fuel Service*

In December 1992, SFPP filed its Tariff No. 18, proposing the transportation on its West Line of a new product, turbine fuel (also known as jet fuel). The rate for the new turbine fuel service was equal to other grandfathered rates in Tariff No. 18 that had been in effect since 1989. The shippers argue that because the turbine fuel rate was not initiated until 1992—long after the grandfathering window had closed (indeed, after the EPAct had been enacted)—the rate cannot be grandfathered. The Commission does not contest this; it recognized that the turbine fuel service was new, and therefore could not be grandfathered. *Id.* at 61,063. It nevertheless foreclosed further challenge to the turbine fuel rate, concluding, as a *substantive* matter, that the turbine fuel rate was just and reasonable. *Id.* at 61,078. The Commission reasoned that because the turbine fuel rate was equal to other Tariff No. 18 rates that had been deemed just and reasonable, "there is no basis for providing a different rate level for turbine fuel at this time." *Id.*

That analysis falls far short of the mark. The fact that the Tariff No. 18 rates were *deemed* just and reasonable does not mean that the rates actually *are* just and reasonable. Perhaps if the Commission had undertaken a substantive review of the reasonableness of the West Line rates listed in Tariff No. 18, then its conclusion that the turbine fuel rate is reasonable—because it is equal to those rates—might be supportable. But here, the West Line rates had been "deemed just and reasonable" by operation of law—solely because they had persisted without challenge for one year prior to the enactment of the EPAct. The turbine fuel rate, not itself eligible for grandfathering, cannot simply piggyback on the grandfathered status of other rates. The Commission's contrary

conclusion reflects a fundamental misapprehension of the nature and purpose of the grandfathering provisions of the EPAct. The requirements for grandfathering—the rate must be in effect and not subject to challenge for the year prior to the EPAct's enactment—are not proxies for actual reasonableness. Those requirements instead operate principally as a means to constrain litigation over pre-EPAct pipeline rates. The fact that the turbine fuel rate is equal to other Tariff No. 18 rates thus says nothing about that turbine fuel rate's substantive reasonableness. The Commission's declaration that, as a *substantive* matter, the turbine fuel rate was just and reasonable—a conclusion reached without the benefit of any substantive review of the underlying cost of service and rate of return—was an arbitrary and capricious exercise of the Commission's authority and cannot stand.

2. *Complaints, Protests, or Investigations*

While the WLS concede that most of the West Line rates were in effect for the required year prior to the EPAct's enactment, they contend that no West Line rate is eligible for grandfathering because each of them was "subject to protest, investigation, or complaint" during that same one-year window. In support of their argument, the WLS point principally to protests filed by shippers El Paso Refinery, L.P. ("EPR") and Chevron, and an investigation opened by the Oil Pipeline Board ("OPB") pursuant to those protests. In October 1993, the Commission rejected these arguments, holding that the West Line rates were "presumed just and reasonable" and, therefore, a successful challenge had to "prove the existence of the extraordinary circumstances set forth in section 1803 of the Energy Policy Act." *SFPP, L.P.*, 65 FERC ¶ 61,028, 61,378 (1993); *see also SFPP, L.P.*, 66 FERC ¶ 61,210 (1994) (denying rehearing).

What does it mean for "the rate" to be "subject to protest, investigation, or complaint"? EPAct § 1803(a). The WLS maintain that a general attack on a tariff is sufficient to

challenge all the rates and activities described therein. *See* WLS Br. 14 ("a protest of a tariff filing did subject all rates in the tariff to review"). The Commission, though, in ruling that the shippers' pleadings did not challenge the West Line rates, interpreted this clause of Section 1803 to require that the protest, investigation, or complaint specifically challenge the reasonableness of the rate in question. *See SFPP, L.P.*, 65 FERC at 61,378 n.14 (while Chevron's protest did include "a request for suspension of revised tariff no. 16, which contains . . . only west line rates," the protest "pled no concerns with the existing rates set forth in this tariff"). The WLS object to FERC's interpretation on a general level, arguing that it grafts onto the statute a particularity requirement not found in its text. Here, too, we find the *Chevron* deference that we must accord to the agency's interpretation to be dispositive. Because we cannot say that the Commission's adjudicative interpretation is an impermissible reading of the statute—the statute provides, after all, that it is "the rate" (not the tariff) that must be subject to "protest, investigation, or complaint" —we defer to the Commission's interpretation. And with that interpretation in mind, we turn to the particular contentions of the WLS.

a. *West Line Shipper Protests*

On September 4, 1992, EPR, an East Line shipper, filed a protest to SFPP's Tariffs Nos. 15 and 16, and followed with three supplements that same month, one of which requested the suspension of Tariffs Nos. 15 and 16 and that the Oil Pipeline Board ("OPB" or "Board") open an investigation into the same. That same month, Chevron, which shipped on both the East and the West Line, filed a protest to Tariffs Nos. 15 and 16, also calling for their suspension and investigation.

The WLS contend that because EPR's and Chevron's protests challenged Tariff No. 16—which listed only West Line rates—those protests had challenged the West Line rates. The Commission rejected this contention, looking

beyond the relief requested by the protests to the shippers' substantive arguments for that relief. Examining the relevant pleadings, the Commission concluded that the protesting shippers "raised concerns with only three matters—flow reversal, prorationing, and existing rates on SFPP's east line." *Id.*, 65 FERC at 61,378. As "[n]othing within the four corners of these protests indicate[d] a concern with the existing rates on SFPP's west line," the Commission rejected those protests as a basis for denying grandfathered status to the West Line rates. *Id.*

Our examination of the relevant pleadings convinces us that the Commission correctly concluded that EPR and Chevron did not challenge the reasonableness of the West Line rates in their protests to SFPP's Tariffs No. 15 and 16. The EPR and Chevron pleadings scarcely mention the West Line at all, let alone mount an attack on the reasonableness of its rates. The *only* mention of the West Line rates is found in EPR's first supplement to its protest: "Santa Fe's proposed Tariff Nos. 15 and 16 retain Santa Fe's previously effective rates for service on its East Line and West Line systems, but represent the first tariffs under which product will flow in a reversed direction on the 'Six-Inch Line' portion of the East Line system from Phoenix to Tucson." *In re SFPP, L.P.*, Supplement to Protest of El Paso Refinery, L.P., 1-2 (Sept. 9, 1992) (emphasis omitted). This statement obviously concerns the flow reversal on the Phoenix-Tucson pipe—not the reasonableness of West Line rates. Chevron's protest, as the Commission noted, "simply fails to contain any statement indicating a challenge to existing rates on SFPP's west line." *SFPP, L.P.*, 65 FERC at 61,378. The Commission thus reasonably concluded that these protests by East Line

shippers were insufficient to render the West Line rates "subject to protest." EPAct § 1803(a).[2]

b. *Oil Pipeline Board Investigation*

On September 29, 1992, in response to the protests filed by EPR and Chevron, the OPB, pursuant to its authority under Section 15(7) of the ICA, 49 U.S.C. app. § 15(7) (1988), opened an investigation of SFPP's rates listed in revised Tariffs Nos. 15, 16, and 17, suspended the tariffs for one day, and imposed refund obligations on SFPP. *SFPP, L.P.*, 60 FERC ¶ 62,252 (1992).[3] In April 1993, the Commission vacated the suspension orders and the refund obligations. *SFPP, L.P.*, 63 FERC ¶ 61,014 (1993). Observing that the protests against the tariffs did not challenge any change in a listed rate or practice (such as the addition of the East Hynes origination point or the turbine fuel service), but rather attacked only existing, unchanged rates and policies (the East

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[2] In August 1993, Chevron filed a complaint that *did* specifically challenge the reasonableness of the West Line rates. *See* ALJ Decision, 80 FERC at 65,121. The WLS maintain that this 1993 complaint should "relate back" to its 1992 protest. We do not agree. Relation back is a concept born in the context of statutes of limitations. Amendments to complaints are said to relate back to the date of the original complaint. *See* Fed. R. Civ. P. 15(c). Even assuming that this suggested use of the relation back doctrine could supersede the Commission's own time limitations governing amendments of protests, the WLS concede that to relate back "the claim . . . in the amended pleading [must have] ar[isen] out of the conduct, transaction, or occurrence set forth ... in the original pleading." Fed. R. Civ. P. 15(c)(2). That clearly is not the case here. As the Commission found, Chevron's initial protest "simply fails to contain any statement indicating a challenge to existing rates on SFPP's west line." *SFPP, L.P.*, 65 FERC at 61,378.

[3] After SFPP filed Tariff No. 18, adding the turbine fuel service on the West Line, the OPB, acting pursuant to a protest by Chevron to Tariff No. 18, instituted an investigation and consolidated that case into the open investigation and suspension of SFPP's Tariffs Nos. 15, 16, and 17. *SFPP, L.P.*, 62 FERC ¶ 62,060 (1993).

Line rates and the flow reversal and prorationing practices), the Commission concluded that the OPB lacked authority to open an investigation under Section 15(7) of the ICA, which permits the Board only to investigate newly filed rates or practices. *Id.* at 61,125 ("It was not appropriate for the Board to suspend the proposed tariff changes and initiate an investigation under section 15(7) when the focus of the protest was existing, unchanged, portions of the tariff."); 49 U.S.C. app. § 15(7) (1988) (limiting application to "any schedule stating any *new* individual or joint rate . . . or charge") (emphasis added). The Commission held that the case should continue as a complaint proceeding before the Commission under ICA Section 13(1), *id.* § 13(1), and be limited to the issues properly raised by EPR, Chevron, and the intervenors. *SFPP, L.P.*, 63 FERC at 61,125. But as the Board "does not possess delegated authority to order initiation of a section 13(1) proceeding," the Commission vacated the tariff suspensions and the refund obligations. *Id.* The Commission eventually terminated the Board's suspension docket entirely, stating that matters would proceed only in the instant complaint docket. *SFPP, L.P.*, 63 FERC ¶ 61,275 (1993). And based on its conclusion that the OPB's investigation had been unlawfully initiated, the Commission determined that SFPP's West Line rates were not "subject to investigation" for grandfathering purposes. *SFPP, L.P.*, 66 FERC at 61,480.

Parsing with care the words of the Commission's countermand of the Board, the WLS argue that the Commission never formally vacated the Board's investigation of the SFPP's Tariffs Nos. 15-18, and thus the rates within those tariffs—including the West Line rates—remained subject to investigation in 1992, precluding grandfathered status. We, like the Commission, are unpersuaded. First, while the WLS are quite right that the Commission did not, in its ordering clauses, vacate the Board's investigation, the shippers' interpretation of the Commission's action runs head-on into

the Commission's statement that it was inappropriate "to suspend the proposed tariff changes and *initiate an investigation* under section 15(7)." *SFPP, L.P.*, 63 FERC at 61,125 (emphasis added). Moreover, the shippers offer no explanation how such an investigation by the Board could proceed in light of the Commission's order that the case would continue as a Section 13(1) complaint. But even if common sense bowed to formalism and the Board's investigation remained technically open, the scope of the Board's investigation—lawful only insofar as it enforces ICA Section 15(7) —must be limited to newly tariffed rates or practices. *See* 49 U.S.C. app. § 15(7) (1988). As SFPP's tariffs made no changes to the West Line rates (except to add the Watson enhancement and the turbine fuel services), the Board could not have investigated the West Line rates.

We therefore conclude that FERC reasonably determined that the West Line rates (except, as noted above, for the Watson Station enhancement and turbine fuel rates) were grandfathered and therefore deemed just and reasonable under the terms of Section 1803(a) of the EPAct.

C. *Exceptions to Grandfathering*

We turn now to the WLS' contention that the rates fall within the exceptions outlined in Section 1803(b) and therefore are still open to challenge under the ICA. Section 1803(b) permits a shipper to challenge a grandfathered rate if the shipper establishes either that (1) there has been a "substantial change" in the economic circumstances or services provided that "were a basis for the rate"; or (2) "the person filing the complaint" was under "a contractual prohibition against the filing of a complaint" on the date of the enactment of the EPAct. EPAct § 1803(b). The complaining shipper bears the burden of proving the existence of one of the circumstances triggering an exception. The Commission concluded that the WLS had not met either requirement. *See SFPP, L.P.*, 68 FERC ¶ 61,105, 61,581 (1994) (contractual

prohibition); Opinion No. 435, 86 FERC at 61,064-71 (changed circumstances). The shippers were therefore barred by the EPAct from challenging the grandfathered West Line rates. The WLS appeal both rulings.

1. *Substantially Changed Circumstances*

Before the ALJ and the Commission, the WLS argued that there were five circumstances that had substantially changed so as to permit a challenge to the grandfathered West Line rates, including increased throughput on the West Line and the impact of the Commission's *Lakehead* decisions on SFPP's income tax cost allocation. The ALJ rejected all the substantial change arguments. *See* ALJ Decision, 80 FERC at 65,192-96. Concerning the claim based on throughput, the ALJ concluded that the evidence of a forty-percent increase in throughput from EPAct's enactment in October 1992 to 1995 (the last year for which data was obtained), by itself, could not prove a change in economic circumstances. *Id.* at 65,194. Missing, according to the ALJ, was any evidence demonstrating that the increase in throughput produced higher revenues and profits for SFPP. *Id.*

The Commission affirmed the holdings of the ALJ on each of the WLS' claims of substantial change, *see* Opinion No. 435, 86 FERC at 61,064-71, but, with respect to the throughput claim, did so on somewhat different reasoning, *see id.* at 61,067-69. The Commission found that the ALJ had erred by measuring change from the date of enactment of the EPAct, and by using data generated after the filing of the shippers' complaint. *Id.* Determining whether there has been a substantial change in economic circumstances providing the basis for the rate, the Commission held, requires comparing (a) the period before the rate first became effective (the basis for the rate) with (b) the period starting on the date of enactment and ending on the date of the complaint. *Id.* The WLS' substantial change claim based on increased throughput failed because the shippers measured changed circum-

stances against the "wrong base period" and with post-complaint evidence. *Id.* at 61,069. To establish a substantial change, FERC held, the shippers should have compared the period before the West Line rates became effective in 1989 to the period between October 24, 1992 (EPAct's enactment) and August 7, 1993 (the date of Chevron's complaint).

The shippers contest neither the Commission's interpretation of the substantial change provision of EPAct, nor its conclusion that the shippers failed to demonstrate a substantial change under that standard. The WLS do, however, maintain that the Commission's ruling employed a "newly articulated standard" and that they are, therefore, entitled to a remand so that they may have an opportunity to litigate under the Commission's "new" evidentiary requirements. WLS Br. 23. We reject this contention.

Even before the Commission announced this interpretation, the correct points of comparison in a substantial change analysis were clear from the face of the statute. The statute requires a shipper to show a change in economic circumstances "which were a basis for the rate." EPAct § 1803(b). As the Commission noted in its Opinion No. 435, this phrase could only mean "the basis upon which the rate was last considered to be just and reasonable, either as a filed rate, a settlement rate, or one for which the Commission has made a legal determination." Opinion No. 435, 86 FERC at 61,068. Any other moment in time would lack "correlation to the economic circumstances that were the basis of the rate at the time it was designed." *Id.*

The textual clues to the second point of comparison are perhaps less obvious but no less certain. The statute provides that "[n]o person may file a complaint . . . unless . . . evidence is presented ... which establishes that a substantial change has occurred after the date of ... enactment." EPAct § 1803(b). From the "after the date of enactment" language we are given the earliest point at which a shipper may show a substantial

change. The closing date for evidence is the day the complaint is filed; this conclusion follows from the language providing that no "complaint" may be filed unless "evidence is presented" with the complaint that demonstrates that a substantial change "has occurred." As the Commission stated, "[i]t is difficult to see how language that so explicitly uses the past tense could apply to evidence that would be developed at some indeterminate time after the complaint is filed." Opinion No. 435, 86 FERC at 61,069. Because the foregoing requirements of the statute are clear from its face, the shippers had adequate notice of the standard they were required to meet. *See, e.g., Midtec Paper Corp. v. United States*, 857 F.2d 1487, 1510 (D.C. Cir. 1988) (rejecting petitioner's argument that it had inadequate notice specific evidence was required to support its complaint where the text of the regulations at issue "clearly indicates" that such evidence was to be considered).[4]

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[4] *Consolidated Edison Co. v. FERC*, 315 F.3d 316 (D.C. Cir. 2003) and the other cases cited by the shippers (*see* WLS Br. 23) are distinguishable. Those cases stand for the unremarkable proposition that when an agency abandons its own precedent in the course of an adjudication, the new rule may be applied retroactively to the parties only "so long as the parties . . . are given notice and an opportunity to offer evidence bearing on the new standard." 315 F.3d at 323 (citing *Hatch v. FERC*, 654 F.2d 825, 835 (D.C. Cir. 1981)). Here, FERC did not abandon its own precedent. Shippers point to *Santee Distrib. Co. v. Dixie Pipeline Co.*, 71 FERC ¶ 61,205 (1995), *reh'g denied*, 75 FERC ¶ 61,254 (1996), but that ruling—issued nearly two years after Chevron's complaint was filed, and several months after the parties had submitted their direct cases to the ALJ, *see* ALJ Decision, 80 FERC at 65,121—stands solely for the proposition that, to make out a substantial change under EPAct Section 1803, the complainant must show some change in circumstances since the enactment of the EPAct. *See Santee Distrib. Co.*, 71 FERC at 61,754 ("Comparisons of data for 1987 to data for 1993 cannot be the basis for showing a change in economic circumstances since enactment of the EPAct."). That holding is entirely consistent with the holding of Opinion No. 435.

The WLS also argue that the Commission erred in rejecting their argument that the Commission's decision in *Lakehead Pipe Line Co., L.P.*, 71 FERC ¶ 61,338 (1995) (*Lakehead*), *reh'g denied*, 75 FERC ¶ 61,181 (1996) ("*Lakehead II*"), insofar as it changed the ability of limited partnerships like SFPP to include certain income tax allowances in their cost of service, represented a substantial change in SFPP's economic circumstances. The Commission reasoned that the mere existence of the *Lakehead* policy, without any showing how the application of that policy affects the economic basis for the rates, cannot constitute substantially changed circumstances. *See* Opinion No. 435, 86 FERC 61,070-71. In light of our conclusion below that aspects of the Commission's *Lakehead* policy are arbitrary and capricious, we think the best course is to remand this claim to the Commission for further consideration in light of our disposition in this case.

2. *Contractual Prohibition*

The WLS next contend that they may challenge the grandfathered West Line rates because they fit within the "contractual prohibition" exception. That exception allows a shipper to challenge a grandfathered rate when "the person filing the complaint was under a contractual prohibition against the filing of a complaint which was in effect on the date of enactment of [the EPAct] and had been in effect prior to January 1, 1991." EPAct § 1803(b)(2). Navajo, as a part of an earlier settlement with SFPP, was subject to such a prohibition and thus was permitted to file a complaint against the West Line rates without demonstrating substantially changed circumstances. *See SFPP, L.P.*, 67 FERC ¶ 61,089, 61,254 (1994). Navajo, however, reached another settlement with SFPP and withdrew its complaint against the pipeline. *SFPP, L.P.*, 79 FERC ¶ 63,014 (1997). The Commission then terminated the Navajo complaint proceeding. *SFPP, L.P.*, 80 FERC ¶ 61,088 (1997).

The WLS nevertheless argue that they, too, should not have to show substantially changed circumstances. First, they assert that Navajo's invocation of the contractual prohibition exception effectively vitiated the West Line rates' grandfathered status as to *all* complaining shippers. *See* WLS Br. 18 ("The 'grandfathered' status of the West Line rates . . . was thus revoked."). Alternatively, the WLS argue that because the ALJ conditioned Navajo's "withdrawal of the complaint" on "not prejudic[ing] in any way the status and rights of any other participants in this proceeding," *SFPP, L.P.*, 79 FERC at 65,176, the other complaining shippers should be able to pursue their complaint as if Navajo had not withdrawn—that is, without showing substantially changed circumstances. The Commission rejected both of these arguments. From the first, the Commission recognized that the contractual prohibition exception is party-specific. "Because neither Chevron nor ARCO/Texaco was subject to a contractual bar [as was Navajo], it follows, under the plain meaning of the language of the statutory provision, that the complaints of Chevron and ARCO/Texaco [must show substantially changed circumstances]." *SFPP, L.P.*, 68 FERC at 61,581. As for the shippers' claim that they had been prejudiced by Navajo's withdrawal, the Commission concluded that the condition on Navajo's settlement applied only to "the integrity of the record." Opinion No. 435, 86 FERC at 61,073.

We agree with the Commission. The language of Section 1803(b)(2) is quite obviously party-specific. EPAct § 1803(b)(2) ("*the person filing the complaint* was under a contractual prohibition") (emphasis added). An interpretation, like that suggested by the WLS, that would allow other shippers to piggyback on the status of a contractually-prohibited shipper, conflicts not only with the plain language of the statute, but also with Section 1803's overarching purpose of limiting litigation over pre-EPAct rates. On the other hand, the Commission's interpretation—limiting the

exception to those parties actually contractually prohibited from complaining—is entirely consistent with the statute and therefore reasonable. We also find no merit to the WLS' claim that they were somehow prejudiced by Navajo's settlement. After examining the relevant proceedings, *see SFPP, L.P.*, 79 FERC at 65,176, we think it clear that the ALJ, in implicitly promising that Navajo's withdrawal would not "prejudice . . . the status and rights of any other participants in proceeding," was referring only to the evidence that Navajo had placed into the administrative record.

II. The East Line

SFPP's East Line rates were not grandfathered under § 1803 of the EPAct, as EPR, as an ELS, had challenged them in the same September 1992 complaint in which it had protested SFPP's flow-reversal on the six-inch line. They were therefore "subject to protest, investigation, or complaint" within the year prior to the EPAct's enactment. Navajo later filed its own complaint against the East Line rates, and the Commission proceeded under the ICA, which, in Section 15, empowers the Commission to set aside rates it finds "unjust or unreasonable," and to "determine and prescribe what will be the just and reasonable . . . rates, fares or charges to be thereafter observed." 49 U.S.C. app. § 15(1) (1988). The ALJ evaluated SFPP's East Line rates pursuant to its cost of service regulations, 18 C.F.R. § 346.2 (2004), found them unjust and unreasonable, and proceeded to set new ones in their place. ALJ Decision, 80 FERC at 65,122-191. The Commission substantially affirmed the ALJ's determination in Opinion No. 435, 86 FERC at 61,084-111. Under the Commission's rate-of-return methodology, this involved determinations of SFPP's embedded capital costs, its yearly operating expenses, allowances for other costs, and its appropriate rate of return. *See* 18 C.F.R. § 346.2(c).

The proceedings before the Commission were complex, and many of the issues it decided in setting new East Line rates (and in determining that the previous rates were unjust or unreasonable) have not been challenged. As relevant to our review, the parties dispute only four discrete issues regarding the Commission's East Line rate-setting: (1) the starting rate base to which SFPP was entitled; (2) what tax allowance, if any, should be factored into rates; (3) the proper means of recovery, if any, of SFPP's litigation expenses; and (4) the treatment of SFPP's claimed expenses for reconditioning portions of the East Line.

The court reviews the Commission's ratemaking decision to determine whether it was arbitrary and capricious, *see Association of Oil Pipelines v. FERC*, 83 F.3d 1424, 1431 (D.C. Cir. 1996) ("*AOPL*"), according special deference to the Commission's expertise, *id.* at 1431; *see also In re Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968). The court thus examines the Commission's ratemaking decisions to determine whether the Commission has examined the relevant data and articulated a rational connection between the facts found and the choice made. *AOPL*, 83 F.3d at 1431. The Commission must "cogently explain why it has exercised its discretion in [the] given manner." *Exxon Corp. v. FERC*, 206 F.3d 47, 54 (D.C. Cir. 2000) (quoting *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 48-49 (1983)).

A. *Starting Rate Base*

The Commission decided that to measure SFPP's overall investment upon which it is entitled to a return, SFPP should use its December 19, 1988 capital structure. Opinion No. 435-A, 86 FERC at 61,503-06. In assessing the value of a pipeline's invested capital, the Commission's approach—stemming from its opinion in *Williams Pipe Line Co.*, 31 FERC ¶ 61,377 (1985) ("Opinion No. 154-B")—weighs equity and debt-financed capital investments made prior to

1985 differently, and SFPP contends that the Commission used the wrong historical ratio between the two in setting the starting rate base.

Some explanation of the "starting rate base" concept and its history is necessary. Prior to June 28, 1985, the rate base to be included in oil pipeline cost of service analysis was calculated under an Interstate Commerce Commission ("ICC") valuation method, which combined elements of original and reproduction cost. In *Farmers Union Central Exchange, Inc. v. FERC*, 584 F.2d 408, 417-20 (D.C. Cir. 1978) ("*Farmers I*"), the court expressed concerns about the ICC's valuation methodology, particularly its tendency to overvalue assets so as to "exceed[] investment by a substantial amount." *Id.* at 415. After the Commission proposed to continue to use the ICC's valuation method in *Williams Pipe Line Co.*, 21 FERC ¶ 61,260 (1982), the court, on review from that decision, remanded the case in *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1510-14 (D.C. Cir. 1984) ("*Farmers II*"), and directed the Commission to consider alternatives, noting the widespread agreement among many experts that the ICC's method "lacks any economic rationale." *Id.* at 1511 (internal citation omitted).

On remand from *Farmers II*, the Commission developed its current "trended original cost" method. Opinion No. 154-B, 31 FERC at 61,833-35. This method starts from the original cost of a pipeline's assets but smooths out depreciation and equity recovery over the life of the pipeline, thereby avoiding the front-loading problems associated with a depreciated original cost methodology. Making the switch to this "trended original cost" method required the Commission to account for investments in existence at the time of the change. Under the ICC's valuation rate base methodology, many of these had been valued substantially above investment cost. *See Farmers I*, 584 F.2d at 415. Setting their

value to depreciated original cost would, in many cases, have significantly decreased their valuation for rate-setting purposes. *See* Opinion No. 154-B, 31 FERC at 61,836. To mitigate any abrupt reduction in pipeline earnings resulting from the change, the Commission permitted a one-time rate base adjustment—creating a so-called starting rate base—calculated by partially continuing the ICC's valuation method to the extent of a pipeline's equity ratio, but assessing its rate base at depreciated original cost to the extent of its debt ratio. Opinion No. 154-B, 31 FERC at 61,835-37. Because the stated purpose of this approach was to protect the expectations of investors who had invested prior to the switch, the Commission determined that the relevant debt-to-equity ratio would be a pipeline's capital structure as of the date of Opinion 154-B, June 28, 1985, rather than its capital structure at the time rates are set. *See Williams Pipe Line Co.*, 33 FERC ¶ 61,327, 61,640 (1985) ("Opinion No. 154-C").

The court has never reviewed the reasonableness of the Commission's Opinion No. 154-B methodology, nor need we do so now, as no party has challenged whether that approach is faithful to the court's remand order in *Farmers II*, 734 F.2d at 1511-21. The ELS support the Commission's application of the Opinion No. 154-B methodology, and SFPP contends only that the Commission's use of December 19, 1988 rather than June 28, 1985 as the relevant snapshot of the pipeline's capital structure is not faithful to Opinion No. 154-B and its progeny. We turn, then, to SFPP's contention that the Commission acted arbitrarily and capriciously, and departed from past precedent without adequate explanation, in rejecting use of the actual June 28, 1985 capital structure of the Santa Fe Southern Pacific corporation ("SFSP"), the pipeline's then-parent.

SFPP did not yet exist in 1985, and its predecessor corporation, Southern Pacific Pipelines, Inc. ("SPPL"), was a wholly-owned corporate subsidiary of SFSP. SPPL therefore

had a 100% equity structure, and no party urged the Commission to use that capital structure to calculate SFPP's starting rate base. SPPL's parent, SFSP, was capitalized at 78.29% equity and 21.71% debt at the time, and SFPP urged the Commission to follow Opinion No. 154-B's instruction to use the parent's capital structure to calculate the starting rate base. Initially, in Opinion No. 435, 86 FERC at 61,089-90, the Commission took the position that the 1988 settlement agreement between SPPL and several of its shippers, which had last set the pipeline's rates, required the use of SFSP's capital structure in the starting rate base. On rehearing in Opinion No. 435-A, however, the Commission decided that the settlement did not preclude it from independently examining SFPP's capital structure after the rates set by the settlement expired. The Commission determined that SFSP's capital structure should not be used in the starting rate base calculation because SFSP's high equity component in June 28, 1985 did not "accurately reflect[] the risks of SFPP's underlying operations," and there was a "significant difference in the nature of the pipeline's operations and those of its parent company on June 28, 1985." Opinion No. 435-A, 91 FERC at 61,504-05.

SFPP contends that Opinion No. 154-B requires, in cases where a pipeline is owned by a parent company and therefore does not issue debt in its own name, the use of a parent company's capital structure as of June 28, 1985. Opinion No. 154-C, which clarified Opinion No. 154-B, does contain the instruction that "the capital structure to be used in determining the starting rate base is as of the date of Opinion No. 154-B (June 28, 1985)." 33 FERC at 61,640. The Commission qualified that approach, however, in *ARCO Pipe Line Co.*, 52 FERC ¶ 61,055, 61,233-34 (1990), where it began applying its precedents from the rate-of-return context—in which it first examines whether a parent company's capital structure is representative of its subsidiary's risk level before imputing it to the subsidiary—to the capital structure

used in the starting rate base calculation. While the Commission in *ARCO* ended up using the corporate parent's actual capital structure, it indicated that its decision to do so hinged on "whether the capital structure is representative of the pipeline's risks." *Id.* at 61,233.

ARCO did not contain much by way of explanation about why the representativeness of a parent's capital structure to the pipeline's risks should matter; its relevance to the starting rate base, where the equity component is standing in as a measure of investor reliance on the old ICC valuation method, appears less obvious than in the rate-of-return context, where pipelines receive different returns on debt and equity to compensate for their different risk levels, *see, e.g., Kuparuk Transportation Co.*, 55 FERC ¶ 61,122, 61,375-78 (1991); *Alabama-Tennessee Natural Gas Co.*, 25 FERC ¶ 61,151, 61,417-18 (1983). But the Commission's basic premise that a capital structure representative of a pipeline's risks must be used in the starting rate base calculation is not at issue, for SFPP concedes that the Commission can depart from a parent's actual capital structure if it is "not . . . representative of the pipeline's risks." SFPP Pet. Br. 17. SFPP's challenge goes only to whether the Commission made a reasoned decision applying that standard, and nothing about the Commission's determination of SFPP's, SPPL's, and SFSP's relative risk levels was arbitrary or capricious.

The Commission noted that the bulk of SFSP's business was in the railroad, trucking, and mineral exploration Industries, which faced substantially higher amounts of competition than the pipeline, a regulated "monopoly for the entire period" guaranteed a fair rate of return and "sufficiently secure that it proposed to undertake a major expansion beginning in 1985." Opinion No. 435-B, 96 FERC at 62,067. Most importantly, the Commission had a powerful piece of evidence of the pipeline's relatively low risk level: its initial public offering. When it first became a stand-alone entity on

December 19, 1988, SFPP was able to adopt a capital structure financed with 60.74% debt and 39.26% equity. This strongly suggests a market judgment that the pipeline was significantly less risky than SFSP, which was financed with 78.29% equity and 21.71% debt. The Commission's view that SFPP's equity level as of its initial public offering more "accurately reflect[ed] the pipeline's risk" than that of its previous parent was based upon a reasoned view that "the financial market's perceptions of the pipeline's risk," as demonstrated through an "arms length public offering," provide an accurate estimate of an entity's risk level. 96 FERC at 62,068. SFPP misses the mark when it states that there is no single capital structure dictated by the market, for although other reasonable debt-equity ratios might have been adopted for SFPP, none would have market imprimatur. The reasonableness of the Commission's position is confirmed by the very different nature of the respective entities' business operations and the stark contrast between the capital structures each adopted. The same reasoning explains the Commission's choice to use December 19, 1988, the date of SFPP's initial public offering, as the relevant snapshot of its equity level, hardly an arbitrary date given its reliance on the judgment of the financial markets.

SFPP maintains, however, that by adopting SFPP's December 19, 1988 capital structure for purposes of the starting rate base calculation, the Commission improperly applied it "retroactively," thereby denying the pipeline a fair chance to bring itself in line with the capital structure hypothesized. The Commission's use of the December 19, 1988 capital structure was predicated on the conclusion that it was representative of the pipeline's risks in 1988, and that there were "no rational grounds here to believe that SPPL's operations or business substantially changed between June 28, 1985 and December 19, 1988." Opinion No. 435-B, 96 FERC at 62,067. SFPP points to nothing that suggests otherwise. The starting rate base is an element of the deter-

mination of the prospective rates "in dispute in this proceeding," and the Commission was neither altering past rates nor seeking to recover the pipeline's past losses in future rates; rather, it was determining a just and reasonable valuation of the pipeline's investment for the purpose of setting present rates. As such, there was nothing "retroactive" about the Commission's setting of the starting rate base.

Because the record contained sufficient evidence on which the Commission could find that SPPL faced significantly lower risks than SFSP in 1985, and SFPP concedes that the Commission may depart from an actual capital structure in the starting rate base formula where it is not representative of a pipeline's risks, the court has no occasion to decide whether the Commission improperly relied on non-record material from Moody's Transportation Manual regarding the poor financial condition of the Southern Pacific Railroad during the relevant period. Nor need we decide whether the Commission's other basis for departing from SFSP's 1985 capital structure—its concern that SFSP's 78.29% equity component would yield an exorbitantly high starting rate base—would suffice to uphold its decision. Accordingly, we affirm the Commission's starting rate base decision.

B. *Cost Issues*

1. *Income Tax Allowance*

As one element of the cost of service allowable to SFPP, FERC included a 42.7% income tax allowance reflecting the interest in the regulated entity held by a subchapter C corporation. All petitioners assigned this tax allowance as error. The shipper petitioners, and intervenors supporting them, allege as error the recognition of any income tax allowance as SFPP is a limited partnership that pays no income taxes. SFPP alleges as error the denial of a full income tax allowance. Because FERC has not established that its 42.7% allowance is the product of reasoned deci-

sionmaking and indeed has provided no rational basis for this part of its order, we find that allowance to have been erroneous and we vacate.

There is no question that as a general proposition a pipeline that pays income taxes is entitled to recover the costs of the taxes paid from its ratepayers. We explained this proposition thoroughly in *City of Charlottesville v. FERC*, 774 F.2d 1205 (D.C. Cir. 1985) (Scalia, J.). While we will not fully discuss the analysis set forth in that decision, we will briefly review the basic principles as background for the current controversy.

The Commission must ensure that the rates of jurisdictional pipelines are "just and reasonable." *Id.* at 1207 (quoting 15 U.S.C. § 717c(a) (1982)). This means that using the principles of cost of service ratemaking, Commission-approved rates must yield "sufficient revenue to cover all proper costs," and provide an appropriate return on capital. *Id.* (citing *Pub. Serv. Co. of New Mexico v. FERC*, 653 F.2d 681, 683 (D.C. Cir. 1981)). Taxes, including federal income taxes, are costs. *See id.* at 1207. The difficulty in the application of this seemingly straightforward principle arises when "the utility is part of a consolidated group," only a portion of which is regulated. *Id.* Historically, the Commission has employed two differing methodologies for attribution of tax costs in dealing with this difficulty. Again, *City of Charlottesville* provides the background for understanding the two methodologies. Under the older, "flow-through" methodology, the Commission "derive[d] an effective tax rate by determining the ratio of each [regulated] pipeline's taxable income to the total taxable income of all affiliates, multipl[ied] this fraction by the group's consolidated tax liability, and divide[d] this figure by the pipeline's taxable income." *Id.* at 1207. Under the more recently derived "stand-alone" methodology, the Commission has sought to segregate the regulated utility, then determine

"the taxable income and deductions . . . specifically attributable to the utility's jurisdictional activities." *Id.* Under this approach, the Commission then applies "the statutory tax rate . . . to the tax base to yield the stand-alone tax allowance." *Id.* The present controversy arises from the fact that neither of these historic methods can by its terms be literally applied to the rates of SFPP.

The name of the jurisdictional pipeline operator explains the origin of the difficulty. SFPP, L.P., is a limited partnership—specifically a publicly-traded one. Both the flow-through and stand-alone methodologies presume taxable income generated by the regulated entity. Each arose in the context of corporate ownership of a jurisdictional pipeline by a tax-paying corporation which is part of an affiliated group. Shipper petitioners concede that were SFPP a subchapter C corporation, a tax allowance would be appropriate in order "to insure that the regulated entity has the opportunity to earn its allowed return on equity." *Lakehead*, 71 FERC at 62,314. But a limited partnership operating jurisdictional pipelines incurs no income tax liability. 26 U.S.C. § 7704(d)(1)(E). Therefore, shipper petitioners contend there is no rational basis for FERC to approve an income tax allowance for a limited partnership that incurs no income taxes. Thus, shippers argue, FERC erred in allowing even a 42.7% tax allowance in the rates of SFPP.

Shippers raised this argument before the Commission and the Commission discussed it in Opinion No. 435. *See* 86 FERC at 61,101-07; *see also* Opinion No. 435-A, 91 FERC at 61,508-09; Opinion No. 435-B, 96 FERC at 62,077-78. In all of its iterations, FERC's discussion of the issue has been in terms of the "*Lakehead* policy." FERC first announced that policy in *Lakehead*, 71 FERC ¶ 61,338, and offered certain clarifications of the policy in *Lakehead II*, 75 FERC ¶ 61,181. That case also involved ratemaking of a limited partnership. In *Lakehead*, the Commission declared that where a regulated

pipeline is a non-taxed limited partnership, it will not be permitted the same tax allowance as it would if the pipeline company were a corporation. However, FERC further ruled that where the limited partnership includes corporate partners, it would treat the partnership as being "in essence a division of each of its corporate partners" for purposes of determining an income tax component in the partnership's cost of service computation. *Lakehead*, 71 FERC at 62,315. Importantly, FERC's opinion in *Lakehead* was never subjected to judicial review, and neither this court nor any other circuit has ever passed on the validity of the *Lakehead* policy. Therefore, while FERC may deem itself bound to follow that policy, we are not so bound and consider its validity for the first time in this application. All petitioners urge us to reject it in whole or in part, though for differing reasons.

Commencing with the assumption that it should apply the *Lakehead* policy to SFPP's ratemaking, FERC considered the question before it to be the determination of how that policy applied to a limited partnership composed of one partner (or partners) that is a subchapter C (taxpaying) corporation and other partners that are not subchapter C corporations but rather individuals, subchapter S corporations, trusts, or other entities that do not incur corporate income tax. FERC's analysis is rooted in the rationale offered in *Lakehead*, discussed in the ALJ Decision, *see* 80 FERC at 65,179, and adopted by the Commission in Opinion No. 435, *see* 86 FERC at 61,102. The Commission bases that rationale on the "double taxation" incurred in the context of subchapter C corporations, in which the profitmaking corporation is liable for corporate income tax and the shareholders of the corporation are individually liable for their individual income tax on dividends generated by the profitmaking corporations.[5]

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[5] In our discussion of the double-taxation rationale, we are advertent to actual and proposed changes in corporate and dividend taxation occurring after the ratemaking we now review. In view of the timing of the

The Commission in *Lakehead* ruled that "because the corporate tax is an extra layer of taxation, the Commission includes an element for the corporate taxes in the cost-of-service to insure that the regulated entity has the opportunity to earn its allowed return on equity." 71 FERC at 62,314. This same rationale guided the Commission's computation of tax allowance for the nontaxpaying limited partnership, including one or more subchapter C partners, throughout the *Lakehead* administrative litigation and the SFPP ratemaking now before us. Because SFPP, Inc., a subchapter C corporation, held a 42.7% interest[6] in the SFPP limited partnership, the Commission included in the cost of service computation for SFPP, L.P., a 42.7% allowance for income taxes that would have been incurred had the pipeline's jurisdictional earnings been subject to corporate taxation. 86 FERC at 61,103.

Shippers contend that FERC erred in including this income tax allowance, arguing that the ALJ was correct that because no income taxes have been or will be paid on SFPP's partnership income, the inclusion of an income tax allowance in the cost of service constitutes allowance for "phantom taxes." *Id.* SFPP, on the other hand, contends that the 42.7% allowance is in fact inadequate to reflect cost of service. It argues that the *Lakehead* policy results in an understatement of the appropriate income tax allowance, and that the Commission should have applied a version of the "stand-alone" methodology discussed above, treating the regulated entity as if it alone were responsible for taxes which would have been incurred on the same income had the jurisdictional pipeline been a taxable corporation.

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ratemaking, and of our resolution of this issue, no such changes are germane to our further analysis.

[6] A 41.7% limited partnership interest and a 1% general partnership interest.

Because we conclude that FERC's rationale does not support its conclusion, we hold that inclusion of the 42.7% income tax allowance in the cost of service computation was erroneous and we vacate FERC's order to that effect. We further conclude that SFPP's arguments are not well-taken and reject the proposition that FERC should have included the 100% allowance that SFPP seeks. We further conclude that the shipper petitioners offer a convincing analysis consistent with ratemaking principles and governing law, and that on the record before us SFPP is entitled to no allowance for the phantom income taxes it did not pay.

We cannot conclude that FERC's inclusion of the income tax allowance in SFPP's rates is the product of reasoned decisionmaking. In *Lakehead*, as re-adopted in the opinion before us, the "reasoning" consists of a recitation of separately unassailable statements that do not together constitute a syllogism leading to the conclusion purportedly based on them. The Commission in *Lakehead* reasoned that:

1. Under cost-of-service ratemaking principles a regulated company is entitled to rates that yield sufficient revenue to cover its appropriate costs.

2. Income tax allowance is no different from the allowance for any other costs.

3. When the regulated entity is organized as a corporation, its revenues are taxed at the corporate tax rate and the earnings of the owners (shareholders) of the corporation are then taxed on dividends at their particular rate.

71 FERC at 62,314.

To that point the Commission's statements are unassailable. However, the Commission follows these statements with a rather cryptic statement. "Because the corporate tax is an extra layer of taxation, the Commission includes an

element for the corporate taxes in the cost-of-service to ensure that the regulated entity has the opportunity to earn its allowed return on equity. However, there is no allowance for the taxes paid by the owners of the corporation." *Id.* Again, the second of these two sentences is inarguable, but it is not at all clear what the Commission means by the first. It would seem to follow from the Commission's own reasoning in the preceding elements of analysis, as well as fundamental principles of ratemaking, that if the corporate tax is to be included in the cost-of-service, it is not because it is "an extra layer of taxation," but rather because it is a *cost*. *Id.* In the Commission's own words, a tax allowance is "no different from the allowance for any other costs." *Id.* Presumably whatever tax rate was applicable to a tax-paying regulated entity would be included in the cost-of-service analysis, nor does anything said by the Commission in *Lakehead* or in the opinions before us dispute that presumption. From this line of "reasoning," FERC proceeded to conclude that the limited partnership operating a jurisdictional pipeline "is entitled to an income tax allowance with respect to income attributable to its corporate partners." *Id.* The only further explanation that FERC offers for this conclusion is "when partnership interests are held by corporations, the partnership is entitled to a tax allowance in its cost-of-service for those corporate interests because the tax costs will be passed on to the corporate owners who must pay corporate income taxes on their allocated share of income directly on their tax returns." *Id.*

The Commission then goes on to "conclude[] that [the limited partnership pipeline] should not receive an income tax allowance with respect to income attributable to the limited partnership interests held by individuals . . . because those individuals do not pay a corporate income tax." *Id.* at 62,315. Presumably, however, the individual owners pay individual income taxes. Also, presumably many owners (shareholders) of corporate holders of limited partnership interests will not be paying taxes on dividends as corporations often do not

generate dividends.[7] In the original *Lakehead* opinion, the Commission had little further to say about why it distinguished between the corporate taxes of corporate unit holders and the individual income taxes of individual unit holders. In *Lakehead II*, and in the opinions we review today, the Commission did offer some attempt to explain the distinction.

In *Lakehead II*, FERC considered the argument of the *Lakehead* limited partnership that the Commission's refusal to grant a tax allowance reflecting the tax liabilities of all limited partnership unit holders, whether or not each holder was a subchapter C corporation, did not comport with the Commission's own "actual taxes paid" rationale, because the Commission, under the "stand-alone" tax policy discussed above, would permit "a regulated entity to collect a fair tax allowance even where no actual tax liability is incurred." *Lakehead II*, 75 FERC at 61,594. *Lakehead II* went on to argue that under this rationale, even if the jurisdictional entity is a non-taxed limited partnership, "rate payers should be responsible for the tax liability otherwise associated with the revenue generated from the jurisdictional activities, without regard to any actual amount paid to the IRS." *Id.* In rejecting the argument, the Commission stated, no doubt correctly, that in the case of a jurisdictional corporate subsidiary of a corporate group, "the allowed equity return generates an actual tax liability for the pipeline that must be paid to the IRS, either in cash or through the use of another member's deductions . . . . [E]ither way, the tax liability of the jurisdictional company is a real cost of providing service." *Id.* at 61,595 (citing *Northern Border Pipeline Co.*, 67 FERC ¶ 61,194, 61,110-11 (1994)). As applied to tax liability

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[7] As noted in n.5, *supra*, changes in tax laws subsequent to the Commission's opinion herein may further affect the asymmetry of including in ratemaking allowance for the corporate tax of corporate unit holders but not the individual tax of individual unit holders.

generating corporate subsidiaries engaged in jurisdictional activities, the Commission's statement is again quite defensible, when such a subsidiary does not itself incur a tax liability but generates one that might appear on a consolidated return of the corporate group. The difficulty arose when the Commission attempted to take the next step and explain why this reasoning applied to an entity that is a non-taxable limited partnership and to justify discriminating between allowances for the tax liability of corporate unit holders and the tax liability of those unit holders who are individuals or otherwise not subchapter C corporations. The Commission's reasoning on that point extends for two more paragraphs, but is summarized in the following statement immediately following the last quoted language from *Lakehead II*:

> In contrast, there is no corporate tax liability associated with individual partners' equity return and therefore it is not appropriate to allow Lakehead to collect for such amounts in its cost-of-service.

Id. This does not supply reasoning for differentiating between individual and corporate tax liability. It is merely restating the proposition that the Commission is so differentiating. Otherwise stated, the Commission is once again simply declaring: we are including a tax allowance for corporate tax liability; we are not allowing a deduction for individual income tax liability. To re-phrase a proposition is not the same as supplying supporting reasoning. In short, the Commission's opinions in *Lakehead* do not evidence reasoned decisionmaking for their inclusion in cost of service of corporate tax allowances for corporate unit holders, but denial of individual tax allowances reflecting the liability of individual unit holders.

Nonetheless, we could sustain the Commission's decision if the opinions we review had added the reasoned decisionmaking lacking in *Lakehead*. They do not. Before the court, the Commission's counsel argues that the distinction is

justified in the reasoning offered by the ALJ in the portion of his decision affirmed by the Commission. The ALJ, attempting to apply the *Lakehead* policy, had reasoned that "investors in a regulated pipeline are entitled to a return 'commensurate with returns on investments in other enterprises having corresponding risk.'" ALJ Decision, 80 FERC at 65,177 (quoting *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944)). Still struggling with the *Lakehead* policy which had permitted a corporate income tax allowance but not an allowance for the tax liability of other investors in the limited partnership, the ALJ concluded "because there is no dual taxation, a tax allowance is not necessary to ensure that an individual limited partner obtains a 'commensurate return.'" *Id.* We agree that the ALJ's invocation of the *Hope Natural Gas Co.* principle was apt, but unlike the Commission, we agree that the conclusion he based it on was sound.

The *Hope Natural Gas* decision did not itself involve attribution of tax liability for purposes of determining allowances and ratemaking. It did however, apply general principles of ratemaking that are instructive in that context. As the Commission argues to us, that decision teaches that the Commission's ratemaking function involves "a pragmatic assessment of whether the rates prescribed for a pipeline will support its services and provide a reasonable return to its investors." FERC Br. 60 (citing *Hope Natural Gas*, 320 U.S. at 602; *Farmers II*, 734 F.2d at 1502). However, the Commission's premise again does not lead to the Commission's conclusion. The ALJ correctly derived from *Hope Natural Gas* the more specific principle that the regulating commission is to set rates in such a fashion that the regulated entity yields returns for its investors commensurate with returns expected from an enterprise of like risks. Were the corporate unit holders investing in a non-regulated entity of like risk and otherwise similar return, they would of course expect to pay their own corporate tax on any profit they might realize from that investment. Should that profit generate

dividends from the corporations, the shareholders would expect to pay their own taxes on such dividends.[8] Likewise, individual investors in such a non-regulated enterprise would expect to pay their individual taxes thereon. Granted, the second group of investors would pay one level of taxation; the first group, at least potentially, two layers of taxation. This is a product of the corporate form, not of the regulated or unregulated nature of the pipeline or any comparable investment or of the risks involved therein. Therefore, consistent with *Hope Natural Gas*, the ALJ correctly concluded that where there is no tax generated by the regulated entity, either standing alone or as part of a consolidated corporate group, the regulator cannot create a phantom tax in order to create an allowance to pass through to the rate payer. The Commission erred when it rejected the ALJ's conclusion.

As we have recited repeatedly above, and as the Commission itself has recognized in this very proceeding, under cost-of-service principles, a regulated company is entitled to a rate design to yield sufficient revenue to cover its appropriate cost; income tax allowance is no different from the allowance of any other costs. The regulated pipeline generates many costs, for example bookkeeping expenses. Presumably those bookkeeping expenses are recoverable in its rates. Its corporate unit holders, if any, presumably also have bookkeeping expenses. The bookkeeping expenses of the corporate unit holders are not recoverable in the rates of the pipeline, even though the corporation and its shareholders each may independently be paying bookkeepers and accountants unlike individual unit holders who pay only for their own accounting. All of this makes sense. It makes equal sense when applied to income taxes.

SFPP, while raising its own objections to the *Lakehead* policy, joins the Commission in opposing the shipper peti-

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[8] *See* footnotes 5 and 7, *supra*.

tioners' arguments that no income tax allowance should be included in the ratemaking. SFPP, however, argues that the Commission not only did not err in including the potential tax liability of its corporate unit holders, it instead erred in not including the potential tax liability of its individual or other non-subchapter C corporate unit holders. That argument serves to illustrate further why the ALJ was correct in including no such pass-through or phantom taxes at all. Under the Commission's present order, the imputed tax liability of the corporate unit holders creates an allowance included in the making of the rate for the pipeline. The ratepayers pay that rate for the product shipped, but the allocation of the nontaxed profit of the limited partnership pipeline is, so far as the record reflects, subject to division among the unit holders rateably according to their interest in the limited partnership, not affected by how their share of the profits will ultimately be taxed. Therefore, even if the Commission's goal of changing the risk analysis of "double-taxed" investors were a valid one, it is not being accomplished. The inclusion of the phantom taxes in the rate changes the profit margin for all unit holders in the untaxed limited partnership, not just those who are under a particular tax structure. Therefore, SFPP may well be correct that if such an allowance were allowable at all, it should have been allowed for the imputed taxes potentially incurred by all unit holders who realized taxable income from the untaxed profits of the limited partnership of the pipeline. For the reasons set forth above, we hold that the first step of this analysis is erroneous -- that is, we hold that no such allowance should be included.

Both FERC and SFPP argue that the position we adopt today is inconsistent with the "stand-alone" methodology approved by this court in *City of Charlottesville*, for reasons related to the so-called "actual tax" principle discussed therein. *City of Charlottesville*, 774 F.2d at 1207, 1215. Again, we will not rehash the full analysis of *City of*

Charlottesville, but simply will remind SFPP that the stand-alone principle as approved in *City of Charlottesville* dealt with the imputation of taxes within a corporate structure where the imputation was made necessary not by the non-taxable, non-corporate nature of the regulated entity, but by the allocation of profits and losses among the related members maintaining separate balance sheets within a consolidated corporate group. While it is true that then-Judge Scalia posited the applicability of the stand-alone methodology to a circumstance in which taxes were "not necessarily . . . paid," *id.* at 1215, that analysis dealt with the use of "actual or estimated taxes paid or incurred" rather than being limited to actual taxes paid. But the part of the *City of Charlottesville* opinion in which that discussion occurred dealt with the argument that the taxes, though properly estimated and actually incurred, might not ever be actually paid because of such factors as losses generated in the corporate structure, or the allocation of profits between and among taxable years in such a fashion as to result in a different tax actually being paid, if any at all. *See id.* at 1214-15. Nothing in the *City of Charlottesville* opinion suggests that it is the business of the Commission to create tax liability when neither an actual nor estimated tax is ever going to be paid or incurred on the income of the utility in the ratemaking proceeding.[9]

Finally, SFPP argues that adopting the *Lakehead* policy and applying it to this case to restrict the allowance to the

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[9] At least equally inapposite is *Carolina Power and Light v. FERC*, 860 F.2d 1097 (D.C. Cir. 1988). SFPP relies on *Carolina Power and Light* for the proposition that "the Commission is not obligated in prospective ratemaking proceedings to match rates dollar for dollar with taxes paid to the Internal Revenue Service." *Id.* at 1101 (internal quotations omitted). There, again, we dealt with the computation of the precise amount of taxes to be passed through, not whether the Commission could create a tax liability out of whole cloth to pass through to rate payers of a non-taxable utility.

taxes of the corporate unit holders as opposed to imputing the taxes of all unit holders "runs directly contrary to legislation in which Congress expressly sought to encourage the publicly traded partnership formed for oil pipelines and other selected industries." Underlying this argument is Congress's 1987 enactment of Section 7704 of the Internal Revenue Code. 26 U.S.C. § 7704 (added by Pub. L. 100-203, Title X, § 10211(a), Dec. 22, 1987, 101 Stat. 1330-403). Under Section 7704, Congress decreed that, in general, publicly traded limited partnerships would be taxed as corporations. However, Congress made the policy decision that for a limited number of industries, including "pipelines transporting gas, oil, or products thereof," limited partnerships should operate without taxation to encourage investment in those critical industries. *Id.* § 7704(d)(1)(E). SFPP argues that because Congress singled out a narrow category of enterprises with the intent to facilitate investment in such enterprises by providing a tax-efficient means to raise capital, FERC's policy is inconsistent with congressional intent because it provides a smaller incentive than would be the case if it granted an allowance for phantom taxes based on all unit holders instead of simply the corporate ones. This is a classic case of an argument proving too much.

SFPP's argument would equally apply to any decision by the Commission that caused the pipeline lower allowances rather than higher. Unsurprisingly, SFPP is able to offer no precedent for the proposition that we should compel the Commission, or any other agency, to adopt a rate structure bringing it into line with the perceived intent of Congress to achieve objectives in general, as opposed to consistency with the mandate adopted by Congress in furtherance of such objectives. As we have noted in other contexts, congressional mandates to agencies to carry out "specific statutory directive[s] define[] the relevant functions of [the agency] in a particular area." *Michigan v. EPA*, 268 F.3d 1075, 1084 (D.C. Cir. 2001). Such a mandate does not create for the

agency "a roving commission" to achieve those or "any other laudable goal." *Id.* The mandate of Congress in the tax amendment was exhausted when the pipeline limited partnership was exempted from corporate taxation. It did not empower FERC to do anything, let alone to create an allowance for fictitious taxes.

For the reasons set forth above, we vacate the tax-allowance portion of the FERC opinion and order allowing recovery for income taxes not incurred and not paid.

2. *Litigation Costs*

This case has been an expensive one. At the time of the ALJ Decision, 80 FERC ¶ 63,013, SFPP sought to recover $15.1 million for litigation expenses and associated costs related to Commission and certain civil litigation. This included a $12 million litigation expenses reserve plus $3.1 million that SFPP claimed was a direct expense associated with this rate proceeding and related civil litigation. By the time this case reached its second rehearing in 2001, Opinion No. 435-B, SFPP's actual costs appear to have ballooned much higher; the pipeline's 2002 compliance filing places its cumulative costs litigating this rate proceeding, as well as litigating and settling related civil litigation, at over $48.1 million.

a. *Rate Litigation*

In keeping with *Iroquois Gas Transmission Sys. v. FERC*, 145 F.3d 398 (D.C. Cir. 1998), and its own precedents, the Commission considered SFPP's rate litigation to be "part of its normal, ongoing operations" and allowed SFPP to recover these costs from shippers. It did not, however, permit recovery through a permanent rate increase. Reasoning that SFPP's regulatory litigation costs, if "includ[ed] in embedded rates," would "artificially inflate the level of rates between rate cases," because the rate proceeding that caused most of the costs was now over and was not likely soon to recur, the

Commission refused to factor them into SFPP's indexed rates. Instead, the Commission allowed SFPP to recover its actual regulatory litigation costs in the form of an amortized five-year surcharge, with recovery of costs incurred after the 1994 test year offset by the amount which SFPP had collected in excess of the just and reasonable rates from shippers that did not file complaints within the appropriate period. The court reviews, therefore, two distinct decisions of the Commission: to use a temporary surcharge in lieu of a rate increase to recover SFPP's rate litigation costs, and to offset the post-1994 surcharge by the amount of reparations that would have been due non-complaining shippers.

No party challenges the Commission's decision that SFPP's rate litigation costs are recoverable. This does not mean, however, that SFPP was automatically entitled to have those expenses treated as part of its indexed rates, as if the unusually high costs it incurred in this proceeding would regularly recur until the next rate proceeding. SFPP contends that it was entitled to have a litigation reserve factored into its cost of service, because it incurred significant regulatory litigation expenses in the test year, 1994, and was bound to continue to incur costs litigating matters before the Commission in the future. Yet nothing in the record suggests that any other matters SFPP has pending before the Commission will generate costs close to those in this rate proceeding. A glance at SFPP's compliance filing confirms that its litigation expenses have dropped significantly from the levels they reached between 1994 and 1997. The Commission's reasoning for denying the rate increase, that there was "no assurance that SFPP's litigation costs would exceed $2,914,114 a year for the several years that the 1994 rates are likely to remain in effect," Opinion No. 435-B, 96 FERC at 62,075, seems quite reasonable. The Commission has not denied all recovery of these costs but simply limited SFPP's

recovery to its actual costs defending this proceeding and required that those costs be removed from rates once they were repaid.

Where the Commission took a more novel approach was in how it implemented this surcharge. While SFPP was permitted to recover its 1993 and 1994 regulatory litigation costs in full, the Commission offset the surcharge for later years by the amount SFPP had collected, in excess of rates ultimately set by the Commission, from shippers that did not challenge the rates and were therefore not entitled to reparations. SFPP contends that this novel approach of deducting "unclaimed reparations" from the surcharge deprived it of a full recovery, because, in effect, it recovered nothing at all for litigation costs incurred after the test year.

Although the Commission does not cite any precedent for this offset, the apparent novelty of this approach does not render it unreasonable. As the Commission noted, the costs of this proceeding were "high for all parties," and the issue is "how those costs can be most equitably allocated." *Id.* at 62,074. In setting prospective rates, the Commission could reasonably conclude that because SFPP had reaped a windfall by charging rates in excess of those ultimately deemed just and reasonable in the same past years for which it was claiming supplemental expenses above those it would prospectively incur as part of its cost of service, it should be required to first fund its litigation expenses out of that pool before it could begin charging those costs to its customers anew. While SFPP contends that this unfairly benefits shippers that sat on their rights by not filing complaints against SFPP's rates, and that Section 16 of the ICA only authorizes reparations for shippers who have filed such challenges, *see* 49 U.S.C. app. § 16(1) (1988), it presents no justification for being entitled to keep this windfall. The court therefore affirms the Commission's surcharge mechan-

ism and its corresponding offset, subject to the qualification that, depending on what rates ultimately result from this proceeding on remand, the surcharge might require recalculation.

b. *Civil Litigation Expenses*

SFPP also challenges the Commission's decision to disallow recovery in the East Line rates of significant expenses SFPP incurred in civil litigation defending its reversal of flow on a segment of six-inch pipe running between Phoenix and Tucson. SFPP's flow reversal removed capacity from the East Line in order to allocate it to thc West Line. While this benefitted West Line shippers, it would be, as the Commission recognized, inequitable to include these costs in the East Line rates, for "there appears no reason why ratepayers should bear the expense of defending conduct that had no *ex ante* prospect of benefitting them." *See Iroquois Gas*, 145 F.3d at 401; *see also Mountain States Telephone & Telegraph Co. v. FCC*, 939 F.2d 1035, 1043 (D.C. Cir. 1991) ("*Mountain States I*"). The Commission's recognition that litigation of this sort lacks the requisite nexus to the provision of SFPP's East Line service to justify inclusion in those rates was not unreasonable.

SFPP was embroiled in lengthy litigation in Arizona and Texas state courts with EPR and Navajo, two East Line shippers, regarding SFPP's reversal of flow on the six-inch line, one of SFPP's two pipes running between Phoenix and Tucson. That litigation ultimately cost SFPP, according to its 2002 compliance filing, over $23.7 million. SFPP also has an eight-inch pipe running between the two cities. The sixinch line had been in West Line service from 1989 to 1991. When SFPP undertook an expansion of the eight-inch line (which had been in East Line service) SFPP temporarily assigned the six-inch line to the East Line. Upon completion of the expansion project, SFPP entered an agreement with ARCO, a West Line shipper, to return the six-inch line to West Line service, thus restoring West Line service to Tucson. EPR and

Navajo sued to enjoin the reversal, alleging that SFPP had contractually agreed to provide them the extra capacity, that they had engaged in costly investments in reliance on those agreements, and that the line reversal was motivated by a desire to drive the two shippers out of business. As noted, EPR also filed a complaint with the Commission challenging both the flow reversal and SFPP's East Line rates, thereby initiating this rate proceeding. The ALJ dismissed the portion of EPR's complaint dealing with the flow reversal for lack of jurisdiction, noting that because the Commission has no jurisdiction to prevent SFPP from abandoning service on the six-inch line, it also lacks authority to adjudicate allocation disputes as between shippers serving different markets along the line. ALJ Decision, 80 FERC at 65,161-64. No party has sought review of that ruling. The litigation then proceeded in other courts with SFPP ultimately entering into settlements with both shippers.

The ELS' lawsuit based on SFPP's reallocation of capacity from the East Line to the West Line, and the corresponding litigation costs incurred by SFPP, while caused, in the immediate sense, by ELS, were not costs of East Line service or expenditures benefitting the SFPP system generally. They were costs, if anything, of making capacity available to the West Line at the East Line's expense. SFPP did not seek to recover its costs from West Line shippers, either in the cost of service or by capitalizing them into the rate base, presumably because of the Commission's earlier ruling that the West Line rates were grandfathered under Section 1803 of the EPAct, and therefore not subject to increase in this proceeding. Instead, SFPP sought to recover them from East Line shippers.

The Commission rejected this attempt, concluding that SFPP's costs in settling these matters "arose out of litigation unique to the conditions of [EPR and Navajo]," and, as such, were not costs that related to the provision of East Line

service as a whole. Opinion No. 435, 86 FERC at 61,106. On rehearing, the Commission ruled that the costs of litigating these matters were not recoverable, because "civil litigation of this type" involving "assertions of anti-competitive behavior and breach of contract to make capacity available" does not "address legal costs and remedies that SFPP would normally incur in the conduct of its common carrier operations." Opinion No. 435-A, 91 FERC at 61,513. Therefore, the Commission concluded, SFPP's litigation expenses were "extraordinary." *Id.* On further rehearing, the Commission reaffirmed its ruling that SFPP could not recover such litigation costs in its rates. Opinion No. 435-B, 96 FERC at 62,070.

Under the Commission's accounting regulations, extraordinary costs are defined as costs that "possess a high degree of abnormality and [are] of a type clearly unrelated to, or only incidentally related to the ordinary and typical activities of the entity" and are "not reasonably expected to recur in the in the foreseeable future," 18 C.F.R. pt. 352, General Instructions, 1-6(a). SFPP's flow reversal was not itself unique, for it had changed the direction of flow on the six-inch line a year before during the expansion of the eight-inch line. Nevertheless, as none of these prior reversals had generated legal disputes of this scope, the Commission could reasonably conclude that this type of civil litigation, "an action that would not arise in the normal course of the pipeline's operations," was not likely to recur. Opinion No. 435-B, 96 FERC at 62,070.

The remaining question is whether the Commission used the correct standard in determining that these costs were "clearly unrelated to, or only incidentally related to the ordinary and typical activities of the entity." SFPP contends that any reading of this portion of the Commission's regulations must comply with *Iroquois Gas*, 145 F.3d 398, and *Mountain States I*, 939 F.2d at 1034, particularly the

latter decision's admonition that "[i]f expenses are properly incurred, they must be allowed as part of the composition of rates. Otherwise, the so-called allowance of a return upon the investment, being an amount over and above the expenses, would be a farce." *Id.* at 1029 (internal citations omitted).

SFPP's position that capacity allocation litigation is an inevitable cost of doing business with two shipper camps competing for the same markets is not without some persuasiveness. The court has generally taken a somewhat broad view of which litigation costs entities regulated under rate-of-return ratemaking should be permitted to recover. In *Iroquois Gas*, the court vacated the Commission's presumptive disallowance of a gas pipeline's litigation costs defending alleged environmental violations during construction, reasoning that the Commission must analyze whether the purported environmental violations were for ratepayers' benefit rather than simply presuming the imprudence of supposedly illegal activity. 145 F.3d at 399- 403. Similarly, in *Mountain States I*, 939 F.2d at 1029-35, the court vacated an FCC order denying a carrier's recovery of antitrust litigation expenses, and, the same term, in *Mountain States Telephone and Telegraph Co. v. FCC*, 939 F.2d 1035 (D.C. Cir. 1991) ("*Mountain States II*"), remanded a rule presumptively denying recovery of litigation and judgment costs resulting from findings of illegal activity, expressing concern that such a rule might discourage utilities from taking appropriate legal risks that would ultimately benefit their ratepayers. *Id.* at 1042-47.

The Commission stated that it did not consider *Iroquois Gas* apposite because in that case, the underlying activity—construction of the pipeline pursuant to the Commission's certificate authority—was something over which the Commission had jurisdiction and whose prudence the Commission could evaluate. Opinion No. 435-B, 96 FERC at 62,070-71. By contrast, the Commission viewed SFPP's underlying

business decision to reverse flow on the six-inch line as "beyond the Commission's remedial authority." Proceeding on the premise that it lacks jurisdiction over market entry and exit, the Commission apparently takes the position that it is incapable of evaluating the prudence of legal expenses incurred in the course of either, and therefore cannot include them in common carrier rates.

The salient criterion under *Iroquois Gas* and *Mountain States II* for the recovery of legal expenditures by regulated entities is whether the underlying activity being defended in the litigation serves the interests of ratepayers. *See Iroquois Gas*, 145 F.3d at 401-02; *Mountain States II*, 939 F.2d at 1043-47. The court need not address whether the Commission can reasonably deny the recovery of all nonjurisdictional litigation expenses associated with "both [market] entry and exit by the pipeline," Opinion No. 435-B, 96 FERC at 62,070, because the issue in this proceeding is more narrow, and arises only with regard to the inclusion of market exit costs in the East Line rates, not market entry costs in the West Line rates. Whatever might be a common carrier's entitlement to recover any nonjurisdictional litigation costs associated with the initiation of common carrier service, it is not unreasonable for the Commission to refuse to allow a common carrier to charge ratepayers for the cost of taking capacity away from them. The Commission's initial determination that the flow-reversal litigation at issue was unrelated to the provision of East Line service was reasonable, and we affirm on that basis. The Commission recognized that, unlike in *Iroquois Gas*, SFPP's litigation did not "arise[ ] under regulatory obligations that apply to the system as a whole," and noted the "common sense observation that the costs and awards relating to their litigation will be borne primarily by themselves if the litigation and settlement costs are included in the East Line rates." *Id.* at 62,071. As only the East Line rates were at issue, the court understands the Commission's

statement, that SFPP's civil legal expenses arising from the reversal dispute are not those "that SFPP would normally incur in the conduct of its common carrier operations," to refer narrowly to SFPP's "common carrier operations" on the East Line, and not more broadly to SFPP's "common carrier operations" generally. This approach is reasonable, because the cost of cancelling service is not a cost of providing it.

c. *Allocation of litigation costs*

More problematic is the Commission's decision that the East Line rates should bear half of SFPP's recoverable litigation costs. Opinion No. 435-A, 91 FERC at 61,513. The rate proceeding included both East Line rates and the dispute about whether West Line rates were grandfathered. Some litigation costs may have been exclusive to each line, whereas others were common, but the record does not contain precise information regarding how much of SFPP's legal expenses can be attributed to each portion of the rate litigation. The West Line accounts for roughly twice the throughput of the East Line, and the Commission had initially reasoned that due to the more complex nature of the West Line issues litigated in the regulatory proceeding, costs should be apportioned volumetrically between the lines. Opinion No. 435, 86 FERC at 61,106. On rehearing, the Commission reversed itself and split the costs evenly. Opinion No. 435-A, 91 FERC at 61,512. The Commission stated that the ALJ, who initially presided over the case, was "in a position to observe complexity and flow" of the litigation, and could have reasonably concluded that it was the East Line issues, not the West Line issues, that accounted for the "greater portion" of costs generated in the proceeding. *Id.*

The ELS contend that the Commission departed from its well-established volumetric allocation policy for general costs without a rational basis, and thus was arbitrary and capricious in basing its allocation on which shippers created higher

litigation costs. We see nothing problematic in an approach that attributes litigation costs to those for whose benefit the litigation is incurred, and prior Commission cases dealing with legal expenses have allocated them similarly. *See, e.g., Southern California Edison Co.*, 56 FERC ¶ 61,003, 61,021 (1991). A volumetric approach might be appropriate for the recovery of commonly-incurred costs benefitting the entire system, but the Commission's focus here on who "generate[d] the greater portion of a given litigation," Opinion No. 435-A, 91 FERC at 61,513, is reasonable when litigation costs are specific to separately priced services.

The problem with the Commission's litigation-cost allocation is more basic: it lacks substantive analysis. The court is unable to discern why the Commission decided that 50%, as opposed to 40%, 30%, or any other number, fairly reflects the portion of SFPP's litigation expenses attributable to the East Line. It simply claimed to rely on the ALJ Decision for the 50% figure. *See* 80 FERC at 65,167. The ALJ Decision, at best, implicitly adopts the allocation suggested by a Staff witness. Other than describing the Staff's proposal as being developed as a representative amount of litigation expenses for inclusion in the test year cost of service, the ALJ Decision provides no analysis of why such a distribution is warranted. Hence, the Commission's reliance on the ALJ as being in the best position to observe the "complexity and flow" of the litigation leaves unexplained the basis for the allocation. While most of SFPP's litigation cost recovery has been offset by unpaid reparations, and the difference in rates resulting from the allocation may ultimately not be significant, the Commission must still explain its decision. The 50% allocation may or may not be a fair reflection of SFPP's rate litigation costs that were in fact attributable to the East Line. Accordingly, we remand for the Commission to explain its rationale for its allocation, either based on a 50-50 sharing between the East and West Lines or any other allocation it determines would be appropriate.

3. Reconditioning Costs

SFPP sought to have included in its East Line rates a projected annual cost of $3 million for a 15-year pipeline reconditioning program replacing the protective coating on parts of the East Line. Before the Commission, SFPP claimed to have spent upwards of $5.9 million of these reconditioning costs between 1995 and 1998. While acknowledging SFPP's expenditures on the project, the Commission refused to incorporate those costs, most of which were not incurred until after 1995, into SFPP's cost of service because they were too uncertain at the end of the test period in 1994. Opinion No. 435, 86 FERC at 61,106-08. On rehearing, the Commission permitted SFPP to recover its actual expenses from shippers as part of the temporary surcharge it created for SFPP's rate litigation and environmental expenses. Opinion No. 435-A, 91 FERC at 61,518-19. On further rehearing, however, the Commission reversed itself again and denied SFPP all recovery of its refurbishing costs. Opinion No. 435-B, 96 FERC at 62,078-79.

Under its cost of service regulations, the Commission uses a "test year" methodology to determine a pipeline's annual cost of service. This approach looks to the actual costs the carrier incurs in the "test year" and then adjusts for any "known and measurable with reasonably accuracy" costs that "will become effective within nine months after the last month of the available actual experience utilized in the filing." 18 C.F.R. § 346.2(a)(1)(ii) (2004). The test year methodology accounts for the somewhat counterintuitive quality of these proceedings. The Commission, in issuing decisions after 1999 setting SFPP's cost of service for years after 1994, looked not to SFPP's actual costs in those years but rather to what one could have predicted those costs to be, based on what was known in 1994. The Commission noted in Opinion No. 435 that it considers the test year a "relatively rigid concept simply because there must be some point at

which the record closes and there is a known, factual basis for the conclusions." 86 FERC at 61,108. Although this statement appears to mark a change from Commission policy in cases preceding the implementation of its cost of service regulations, where it indicated that it would approach test years more flexibly, *see, e.g., Lakehead*, 71 FERC at 62,313; *Williams Pipe Line Co.*, 21 FERC at 61,658, the Commission's current cost of service regulations provide that it "may allow reasonable deviation from the test period" for "good cause shown." 18 C.F.R. § 346.2(a)(1)(ii).

The ALJ, using 1993 as the base year, decided that the refurbishing costs could not be recovered as part of SFPP's cost of service because the costs had not yet been incurred at that time, and SFPP's predictions of future costs were too uncertain. Finding that SFPP's board had not committed to the refurbishing program as late as 1995 and was simply funding the program year-by-year rather than committing itself to the entire proposed 15-year program, the ALJ reached a series of conclusions: that SFPP might decide to abandon the project or scale it back in the future, that the overall plan was subject to change, that there was little documentation to support estimates of the costs, and that it was uncertain whether significant amounts of the pipeline scheduled for refurbishing might be so corroded as to require outright replacement, which would be treated as a capital investment and factored into the rate base, not as an expense added to cost of service. In Opinion No. 435, the Commission essentially affirmed the ALJ's decision. 86 FERC at 61,106-08.

SFPP contends that the Commission, which used a 1994 base period and the nine-month test period in 1995, could not reasonably affirm the ALJ's decision, which was based on data from an earlier period. There is some record evidence supporting SFPP's claim that it had more firmly committed to the reconditioning project, including beginning refurbishment

of several miles of pipeline in 1995, within "nine months after the last month" of 1994. *Cf.* 18 C.F.R. § 346.2(a)(1)(ii). There was testimony that SFPP's board had approved the project by 1994, that SFPP had recoated 13 miles of the pipeline in 1995, and that its prospective cost estimates were based upon its actual costs thus far.

Nonetheless, it was not unreasonable of the Commission to continue to have doubts about locking so large an expense into SFPP's cost of service (or, to put it more aptly given the test year methodology used here, it was not unreasonable for the Commission to have thought that doubts about the scope of the reconditioning project would still have been proper in 1995). At most the evidence before the Commission showed that, by 1995, SFPP had begun refurbishing certain portions of its pipeline; there was no guarantee from SFPP that the refurbishing would be as ambitious and expensive as claimed. Embedding SFPP's projections into its cost of service would have required its customers to pay for the refurbishing even if the project ultimately resulted in far smaller expenditures than those SFPP had projected. Indeed, given that SFPP now claims to have spent roughly $6 million on the project over four years, when it had predicted costs of at least $3 million a year over fifteen years, the Commission's judgment has been validated by hindsight.

This does not end our inquiry, however, for SFPP also contends that having denied inclusion of reconditioning costs in SFPP's cost of service, it was arbitrary for the Commission not to permit recovery in a surcharge of SFPP's actual costs in 1995-98, which were not found to be imprudently incurred. The Commission's legitimate doubts over the ultimate scope and cost of the reconditioning do not explain the basis for the Commission's decision to deny recovery once actual costs of the project were known. Its decision, rather, stems from a combination of the Commission's test year approach and its interpretation of the filed rate doctrine. In Opinion No. 435-

A, the Commission permitted SFPP to recover its actual reconditioning costs as part of the same surcharge whereby it permitted recovery of SFPP's regulatory litigation costs, similarly offset by any unpaid reparations; any cost not so offset could be included in a surcharge amortized over five years. Yet in Opinion No. 435-B, presented with SFPP's claim that it had expended $5.9 million in actual East Line refurbishing costs between 1995 and 1998, the Commission denied recovery altogether because the expenditures "were not incurred in the 1994 cost of service test period." 96 FERC at 62,078. In responding to protests that its Opinion No. 435-A ruling violated the filed rate doctrine, the Commission concluded "[u]pon further review" that allowing a surcharge for costs not incurred in the test period or with any regularity thereafter "would permit SFPP to recover costs after the fact which were not even present in the test year itself and which thereafter could not be recovered in a cost of service rate filing," and that "[t]o do so after the fact raises serious questions under the filed rate doctrine." Opinion No. 435-B, 96 FERC at 62,078.

The difficulty for the court stems from three sources: the Commission's apparent failure in its test year approach to articulate a clear and consistent approach for dealing with the prudently incurred costs of providing pipeline service that do not regularly recur, the Commission's failure to explain adequately why SFPP's reconditioning costs would not be recoverable in a cost of service rate filing, and its failure to articulate why such a surcharge would violate the filed rate doctrine. Some prudent expenditures involved in the operation of a pipeline that are not capitalized, such as, for instance, rate litigation or refurbishing, are bound to be one-time or infrequent expenditures. A "test year" snapshot of a pipeline's operating costs, therefore, if applied too simplistically, risks over or under-stating the "real" costs of providing pipeline service, depending on whether such costs happen, by chance, to fall in a test year or not. We do not

understand the Commission to apply the test year concept so simplistically; its regulations deal with the possible over-stating problem by disallowing nonrecurring costs as part of the cost of service, *see* 18 C.F.R. § 346.2(a)(1)(I), and both under and over-stating problems by permitting deviation from the test year "for good cause shown," *id.* § 346.2(a)(1)(ii). Yet the Commission's approach in the instant case does not appear to deal consistently with costs incurred outside the test year, as evidenced by its different treatment of SFPP's rate litigation and reconditioning costs between 1995 and 1998. Both appear to be prudent, otherwise recoverable costs; both are nonrecurring (in the sense that they will not be permanent expenditures SFPP can be expected to incur each year); both were incurred chiefly outside the 1994 test year; and the Commission initially held that both past expenses could be recovered in prospective rates through a temporary surcharge because of "benefits that flowed to the system when the costs were incurred." Opinion No. 435-A, 91 FERC at 61,518.

The Commission then reversed course in Opinion No. 435-B and disallowed recovery of the reconditioning costs only. Its reasoning for disallowing one surcharge but permitting the other was that "unlike the [Commission] regulatory costs, none of [SFPP's reconditioning costs] were incurred in the test period." 96 FERC at 62,078. The rate litigation surcharge included SFPP's actual costs after 1994. So the Commission's ruling suggests that it matters, to recovery of costs incurred outside of the test year, whether a carrier also incurred costs of the same general nature in the test year itself. The logic behind this distinction, as applied to costs that benefit the carrier's system but are not expected to regularly recur, is neither explained in Opinion No. 435-B itself, nor is it obvious. Should the Commission wish to rely on this reasoning on remand, it must articulate and justify more carefully what its policy on the recoverability of nontest-year expenses is.

The Commission did explain that SFPP's rates were indexed to account for cost increases after the test year, and that SFPP could not meet the "substantial divergence" standard for showing that indexing failed to account for increases in its cost of service due to reconditioning expenses after 1994. *Cf.* 18 C.F.R. § 342.4(a) (2004). Assuming that the Commission can explain its different treatment of rate litigation and reconditioning costs incurred in years after the 1994 test year, this may be a reasonable basis for denying recovery, but the Commission's opinion provides no analysis for why it is true. Where the Commission had found SFPP's cost of service to be roughly $14 million a year, SFPP was claiming reconditioning costs of roughly $1 million a year, a not insubstantial amount. The Commission provided no estimate or analysis of how any supplemental revenues to SFPP resulting from rate indexing, or from increased throughput in years after 1994, compare to those expenses.

The Commission also stated that permitting recovery of the refurbishing costs "after the fact" would "raise serious questions under the filed rate doctrine." Opinion No. 435-B, 96 FERC at 62,078. The filed rate doctrine "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority." *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981). The Commission did not articulate what type of "serious questions" it thought such recovery would raise. Because a prospective surcharge would presumably be on file with the Commission, the court presumes that the Commission meant that an amortized surcharge, by prospectively recovering SFPP's expenses from past years, would violate the related rule against retroactive ratemaking, which requires that "a utility may not set rates to recoup past losses, nor may the Commission prescribe rates on that principle." *Southern California Edison Co. v. FERC*, 805 F.2d 1068, 1070 n.2 (D.C. Cir. 1986) (quoting *Nader v. FCC*, 520 F.2d 182, 202 (D.C. Cir. 1975)).

This logic, again, raises the question of why such recovery is any more permissible for rate litigation expenses than it is for reconditioning costs. The Commission seems to place SFPP in a Catch-22: it cannot recover its reconditioning costs prospectively or contemporaneously because the cost of the project is too uncertain until the costs are incurred, but then once the costs are certain it is too late because recovery would involve retroactive charges. Absent a better explanation for the Commission's conclusion that SFPP has recovered its reconditioning costs through the indexed rates, it is unclear how the costs of any multi-year project whose cost is not "known and measurable with reasonable certainty" in advance, 18 C.F.R. § 346.2(a)(1)(ii), could ever be recovered, were this reasoning to be consistently adopted. The Commission ruled in Opinion No. 435-A that prospective recovery of SFPP's reconditioning costs would be appropriate because of "benefits that flowed to the system when the costs were incurred," 91 FERC at 61,518, implying that it initially did not view the rule against retroactive rulemaking as an obstacle because the expenses provided an ongoing benefit that would continue to accrue in future years. In light of the Commission's failure to explain why it now considers the rule against retroactive rulemaking (or the filed rate doctrine) to bar recovery, and because no party has briefed this question in any detail, the court remands so that the Commission, if it wishes to continue relying on this reasoning, may better explain it.

The Commission may have answers to these concerns, but they are not provided in the Opinions on review. SFPP's shippers are presently enjoying the benefits of what appears to be an expensive pipeline reconditioning program without sharing in any of its costs. If, in the Commission's opinion, they should not have to, the Commission needs to provide a more thorough explanation of why not. Accordingly, we

remand SFPP's request to recover its reconditioning costs for the East Line between 1995 and 1998 to the Commission for further consideration.

III. Reparations

A. *Background and Proceedings Below*

After determining that SFPP's East Line rates were not just and reasonable, the ALJ ordered SFPP to pay reparations to the ELS which had filed complaints against the rates. ALJ Decision, 80 FERC at 61,308. In Opinion No. 435, the Commission considered various objections to the reparations on the part of both SFPP and the shippers but reaffirmed that SFPP was to pay reparations as determined by the Commission. *See id.* at 61,111-14. Specifically, the Commission ruled that the period for the calculation of reparations would run from the date of each complaint until March 31, 1999, the effective date of revised East Line rates required by Opinion No. 435.

In calculating the potential reparations, the Commission retroactively applied the test year approach it had used to set SFPP's prospective rates: SFPP was to develop an East Line cost of service for a test year, 1994; design a rate that reflected that cost of service; index that rate to December 31, 1998; and apply that indexed rate to designated volumes adopted by Opinion No. 435 for each calendar year for which an indexed rate had been developed. Using the new cost of service thus established for years 1994-1998 and partial year 1999, SFPP was to determine whether the revenues for each period resulted in an over or under-recovery of its cost of service. FERC's order permitted SFPP to "net out its overand under recoveries for each year and determine that net amount, if any, that is due its East Line Shippers." *Id.* at 61,114. FERC ordered a similar calculation of reparations for years prior to 1994 based on the calculation of under or over-recovery of cost of service in those years. As to reparations

in general, FERC held that no shipper was entitled to reparations for periods prior to the filing date of a complaint. *Id.* at 61,112-13.

On rehearing, FERC held that Navajo was the only complainant that had filed a challenge to East Line rates. Thus, only Navajo could recover reparations. Opinion No. 435-A, 91 FERC at 61,514. FERC granted Navajo reparations beginning one month prior to the filing of its December 23, 1993, complaint to SFPP's rates. FERC also noted that Navajo had entered a settlement with SFPP in 1989. That settlement barred Navajo from bringing action against SFPP until November 23, 1993. With those provisos, FERC ordered SFPP to calculate the limited reparations still in order on the East Line based on the difference between per-barrel rates charged and per-barrel rates that would have been charged had SFPP charged cost-based rates using a 1994 test year, and to index such rates annually going forward—in other words, the difference between the charged rates and the rates that SFPP should have charged. In sum, the Commission modified its prior order and decreed that:

> SFPP will calculate the gross reparations that would be due if all shippers that had used the East Line had filed complaints for the applicable reparations period . . . establish[ing] the total revenue that was received in excess of the new East Line rates established by the prior order. Navajo will be paid its *pro rata* share of the reparations for the relevant time frame.

Id. at 61,518. The Commission noted that because Navajo was the only shipper entitled to reparations, the calculations "should leave a surplus of revenues in excess of the East Line restated cost of service between the beginning of the reparations period and the actual date on which the restated rates began to be collected by SFPP." *Id.*

The shippers petitioned for rehearing of FERC's reconsideration order, which FERC granted in part. This time, FERC held that Chevron, Western, ConocoPhillips, and ExxonMobil were, like Navajo, entitled to reparations for overcharges that occurred two years prior to the filing of their complaints. Opinion No. 435-B, 96 FERC at 62,071-74. FERC held that Valero was not entitled to reparations, because its complaint was filed after August 7, 1995, the last date complaints were consolidated in the proceedings. *Id.* at 62,072. The Commission subsequently clarified Opinion No. 435-B by stating that Chevron's eligibility for reparations was determined as of its August 3, 1993 complaint, not a protest it filed September 23, 1992. Clarification and Rehearing Order, 97 FERC ¶ 61,138.

SFPP now argues that the Commission ought not have awarded any reparations whatsoever. Navajo contends that it was improperly denied reparations prior to November 23, 1993. Chevron alleges that FERC improperly set the commencement date for calculating its reparations. And Valero, BP WCP, and Chevron all claim that they were improperly denied reparations.

B. *Analysis*

1. *SFPP*

SFPP argues that the underlying orders were arbitrary and capricious for four related reasons. First, SFPP contends that awarding ELS reparations is impermissible retroactive ratemaking, in violation of the Supreme Court's decision in *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 52 S.Ct. 183, 76 L.Ed. 348 (1932). Second, it asserts that FERC's award of pre-complaint reparations violates the EPAct. Third, SFPP advances that FERC improperly awarded reparations based on a "test period," disregarding damages actually suffered and proved by complainants. Finally, SFPP argues that

FERC failed to consider substantial arguments -- such as the novelty and complexity of SFPP's rate case -- that militated against awarding reparations. For the reasons stated below, we reject all four claims.

a. *The* Arizona Grocery *Rule*

Arizona Grocery proscribes "the retroactive revision of established rates through ex post reparations." *Verizon Tel. Cos. v. FCC*, 269 F.3d 1098, 1107 (D.C. Cir. 2001); *see also Ala. Power Co. v. ICC*, 852 F.2d 1361, 1373 (D.C. Cir. 1988). Otherwise put, *Arizona Grocery* bars reparations that retroactively change a final Commission-approved rate. SFPP relies on *Arizona Grocery* to argue that Opinion No. 435 was a final order prescribing just and reasonable rates, and thus FERC was barred from awarding reparations when SFPP's rate was effectively further lowered as a result of FERC's subsequent orders. SFPP argues that Opinion No. 435 was a final order setting rates "to be thereafter observed" under ICA Section 15(1), and therefore that the subsequent orders were retroactive changes of Opinion No. 435. We disagree.

Arizona Grocery is of no help to SFPP in this case. *Arizona Grocery* applies only where the Commission has "declared what is the maximum reasonable rate to be charged by a carrier." 284 U.S. at 390, 52 S.Ct. at 186. Yet FERC did not finalize a maximum reasonable rate in Opinion No. 435 and in fact repeatedly stated it was not doing so. Thus Opinion No. 435 set no final rate; rather, FERC only established a final rate at the completion of the OR92-8 proceedings. *SFPP, L.P.*, 100 FERC ¶ 61,353, 62,625, 2002 WL 31986493 (2002) ("September 26 Order"). The OR92-8 proceedings were compliance filings. SFPP's filing in Docket No. OR92-8-013 showed SFPP's calculations for determining how its East Line rates should be structured to reflect the requirements of Opinion No. 435-B. SFPP later amended that in Docket No. OR92-8-015 to address the

exclusion of the interest element from the calculation of the total potential reparation pool that would be due under the Commission's prior orders. *Id.* at 62,622.

The record shows that at each point, the Commission said that final East Line rates would not be established until the OR92-8 proceedings were completed. September 26 Order, 100 FERC at 62,625. In response to Opinion No. 435, SFPP filed a tariff establishing a rate, but the Commission concluded that the tariff could not be determined to be just and reasonable until review of the Docket No. OR92-8 compliance filing was completed. The Commission accepted the tariff for filing and suspended it, subject to refund, pending review of the compliance filing. *SFPP, L.P.*, 87 FERC ¶ 61,056, 61,225-26, 1999 WL 214046 (1999). Nor did FERC's next opinion on the subject make that rate final. Opinion No. 435-A merely reaffirmed the suspension of the previously filed tariff based on the significant chance that the proposed rate levels in it would change depending on how the protests and related requests for rehearing were resolved. 91 FERC at 61,520. It did not finalize the rate.

FERC's subsequent orders concerning SFPP's proposed rates were similarly nonfinal. FERC accepted for filing SFPP's Tariff No. 60, filed to comply with Opinion No. 435-A, with a proposed effective date of August 1, 2000, but suspended it subject to refund. *SFPP, L.P.*, 92 FERC ¶ 61,166, 61,563-64, 2000 WL 1211333 (2000). Opinion No. 435-B approved the August 1, 2000, effective date because that was the date the Commission accepted SFPP's compliance filing, and directed a further compliance filing, also to be effective August 1, 2000. 96 FERC at 62,071, 62,079. SFPP filed Tariff No. 67 (later corrected in Tariff No. 68), with a proposed effective date of December 1, 2001. *SFPP, L.P.*, 98 FERC ¶ 61,177, 61,657, 2002 WL 228958 (2002). The Director of the Division of Tariffs and Rates Central rejected the tariffs because Opinion No. 435-B required an

effective date of August 1, 2000. *Id.* FERC's order memorializing the rejection made clear that FERC's previous orders suspended, subject to refund, SFPP's proposed tariffs

> pending resolution of the numerous compliance issues that have been raised in the course of these proceedings. In each of the prior Opinions the Commission has made clear that SFPP must recalculate the rates to be applied in compliance with those Opinions and that any prior calculations of reparations and surcharges must be adjusted accordingly.

Id.

The Commission has thus been clear from the outset and throughout that no final rate determination would be made until the OR92-8 proceedings were complete. September 26 Order, 100 FERC at 62,625. As a result, the Commission's orders requiring reparations do not violate the prohibition in *Arizona Grocery* from subjecting a carrier to payment of reparations with respect to a final rate. The Commission did not establish final lawful rates where it has expressly reserved authority to make adjustments in the context of an ongoing proceeding in which the methodology for determining the rate had not even been established. *Id.* at 62,626.

SFPP contends that the Commission's reparations orders violate ICA Section 15(7), which authorizes refunds of "such increased rates or charges" as "shall be found not justified." 49 U.S.C. app. § 15(7) (1988). But Section 15(7) is an authorization, not a prohibition, and FERC did not invoke this provision in awarding the shippers reparations. The Commission found it inappropriate for this complaint proceeding to go forward under Section 15(7), *SFPP, L.P.*, 63 FERC ¶ 61,014, 61,124, 1993 WL 181572 (1993), and thus no relief was awarded under that section. Rather, FERC proceeded under ICA §§ 8, 9, and 16(1), which specifically authorize the Commission to award damages in a Section 13 complaint. 49

U.S.C. app. §§ 8, 9 & 16(1) (1988). SFPP also contends that FERC lacks authority to issue "interim" rates after ruling on a complaint. Yet nothing in Section 15(1) prohibits FERC from directing a pipeline to file an interim rate, subject to suspension and refund, if there is a possibility that the final rates will be lower than the interim rates. Indeed, the Supreme Court has held that under the ICA the Commission has authority—in response to an initial rate filing—to direct an oil pipeline to file interim rates to go into effect, subject to refund, during the suspension period for the initial rates. *Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 654-56, 98 S.Ct. 2053, 56 L.Ed.2d 591 (1978). *See also FPC v. Tenn. Gas Transmission Co.*, 371 U.S. 145, 146-47, 83 S.Ct. 211, 212-13, 9 L.Ed.2d 199 (1962); *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585, 62 S.Ct. 736, 742-43, 86 L.Ed. 1037 (1942).

Therefore, we hold that when the Commission awarded reparations, it was not constrained by *Arizona Grocery*'s blanket prohibition on retroactive repeals of ratemaking.

b. *Pre-Complaint Reparations*

SFPP's second contention is that the EPAct precludes precomplaint reparations in a Section 13 proceeding, and that each complainant may seek reparations only for overcharges that date from the filing of its own complaint. We disagree. EPAct Section 1803(b) provides:

> If the Commission determines pursuant to a proceeding instituted as a result of a complaint under section 13 of the Interstate Commerce Act that the rate is not just and reasonable, the rate shall not be deemed to be just and reasonable. Any tariff reduction or refunds that may result as an outcome of such a complaint shall be prospective from the date of the filing of the complaint.

EPAct § 1803(b). The ICA, however, allows reparations for up to two years prior to the date of the filing of a complaint if

the rates paid in those two years exceed the just and reasonable rate established in the complaint proceeding. *See* 49 U.S.C. app. § 16(3)(b) (1988).

SFPP contends that the last clause of Section 1803(b) is applicable to any and all complaints filed under ICA Section 13, and therefore that reparations awarded for all complaints—including those for East Line rates—must be prospective from the filing of the complaints. We agree with SFPP that EPAct Section 1803(b) prohibits retroactive ratemaking, but we think that it does so only for those rates that were "grandfathered" under this section. Section 1803(b) does not apply to complaints challenging non-grandfathered rates. In its prefatory clause, it explicitly refers only to "a complaint . . . against a rate deemed just and reasonable under [Section 1803(a)]." The second-to-last sentence of Section 1803(b) expressly relates only to complaints on which FERC acts to determine grandfathered rates, otherwise "deemed to be just and reasonable," to be just and reasonable. The reference to "such a complaint" in the last sentence of Section 1803(b) plainly refers back to the prior references in Section 1803(b) to complaints against rates "deemed to be just and reasonable" under Section 1803(a).

Because the East Line rates were challenged within the one-year period prior to enactment of the EPAct, they are not grandfathered under Section 1803. Accordingly, relief for East Line rate complainants is governed by "the traditional standards of the ICA, including section 16's provision for a two year reparations period retroactive from the date of the complaint." *SFPP, L.P.*, 68 FERC ¶ 61,306, 61,582 (1994).

FERC's order tracked this interpretation of the statute precisely. FERC found that shippers filing a complaint against SFPP's East Line rates may recover reparations for the two-year period prior to the date of their complaints. The Commission determined that the EPAct barred precomplaint relief only for complaints against grandfathered rates. Thus,

FERC correctly found that Section 1803(b) does not apply to complaints challenging the East Line rates that FERC held not to be grandfathered.

c. *Test Period*

Next, SFPP challenges the methodology FERC ordered SFPP to use to calculate reparations. In Opinion No. 435-A, FERC ordered SFPP to use the following method. First, FERC said, SFPP must determine what the just and reasonable rate would have been in each year between 1994 and August 1, 2000—as well as two years back from the date of the earliest complaint—and then calculate what the appropriate gross revenues would have been from that rate. The difference between the gross revenue under the new just and reasonable rates would create the total reparations pool—the amount SFPP would pay to all eligible shippers. SFPP would then calculate the reparations due each eligible shipper (including interest), leaving a residual in the pool of funds that could not be distributed because certain shippers had not filed a complaint within the time frame of the proceeding. The residual pool would then be credited against the total supplemental costs permitted under Opinion No. 435-A between 1995 and 1998. Any remaining allowable costs would then be recovered through a five-year surcharge.

To estimate what gross revenues would have been in those years, the Commission directed that SFPP use a test year cost of service, divided by the test year's volumes, to replace the previous unit rate not found to be just and reasonable. Opinion No. 435-A, 91 FERC at 61,516. The reparations payment due for each year would be the difference between the revenues generated in that year under the old rates and the revenues that would have been generated under the final new rates. *Id.*

SFPP challenges the estimation methodology proposed by FERC—specifically FERC's direction to use a "test period"

to estimate past gross revenues. SFPP contends that basing the reparations calculations on a rate derived from a historical test period "makes no sense in the real world, as it wrongly assumes SFPP's actual cost of service did not change appreciably over a period of eight years or more." We once again disagree.

The use of test periods to set the cost of service for rates intended to span a number of years is well established. *See, e.g., Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d 54, 56 (D.C. Cir. 1999). As we have noted, it is ordinarily impossible for a pipeline to know at the time of filing what its actual costs will be during the effective period of the filed rates, and so the use of a "test period" for calculating the cost of service is appropriate. *Id.* While use of a test period is not perfect, it is a reasonable proxy for actual costs. *See generally American Public Power Ass'n v. FPC*, 522 F.2d 142 (D.C. Cir. 1975); *see also Public Serv. Co. v. FERC*, 832 F.2d 1201, 1218 (10th Cir. 1987). It was therefore reasonable for the Commission to base reparations calculations on the same test period methodology it uses to calculate prospective rates. To the extent SFPP contends that the Commission's reliance on the test year approach unreasonably denied it recovery of certain expenses it incurred after the test period, those concerns are addressed in Part II of our opinion.

The Commission also properly determined that rates based on the test period could be used to calculate reparations for the two years prior to the filing of the complaints. *See* ALJ Decision, 80 FERC at 65,203. There is no basis to conclude that test period rates that are just and reasonable for all future years do not provide a just and reasonable basis for determining reparations in the two years prior to the complaints. *Id.*

SFPP further contends that it should have been allowed to offset under-recovery of its cost of service in some years with

over-recovery of its cost of service in other years, based on ICC decisions permitting netting of multi-year data in determining reparations. As explained, however, the Commission reasonably found that consideration of the costs from every year was not feasible. While the Surface Transportation Board (formerly ICC) determines the total revenue stream required to recover the costs of particular service over its economic life, FERC has reasonably decided to calculate reparations by the difference in the unit value of the old and new rate, not the difference in gross and net revenues for the operation of the pipeline as a whole. ALJ Decision, 80 FERC at 65,203. Accordingly, the Commission reasonably found the netting of reparations across the entire reparations period inappropriate in these circumstances.

Moreover, this Court has previously rejected pipeline demands to permit offsetting undercharges and overcharges in different years during a refund period. As we held in *Belco Petroleum Corp. v. FERC*, 589 F.2d 680, 686-87 (D.C. Cir. 1978), the NGA—like the ICA here—gives the regulated entity no right to collect more than the just and reasonable rate in one period simply because it collected less than the just and reasonable rate in another.

SFPP cites a number of cases for the proposition that the concept of netting multi-year data to assure fairness in reparations is well established, but here a multi-year rate method was not employed. It is thus reasonable to base reparations on a year-to-year basis without netting.

d. *Reasoned Decisionmaking*

SFPP's fourth contention is that the Commission abused its discretion by failing to consider SFPP's arguments. Although SFPP acknowledges FERC's discretion to award reparations, it points out that it argued that SFPP's rate case was complex and presented issues of first impression, and that SFPP could not have predicted what lawful rates would have been. In

sum, it argued before the Commission that it could not have reasonably adjusted its rates. SFPP claims that by giving no consideration to these arguments, FERC failed to engage in reasoned decisionmaking. We reject this contention.

FERC's orders reasonably addressed SFPP's concerns. Although FERC never explicitly responded to SFPP's point that its case was complex, it implicitly did so by finding SFPP's rates unjust and unreasonable. The fact that SFPP's rate case was complex does not alter the Commission's obligation to make a decision as to whether SFPP's rates were unjust and unreasonable. The Commission reasonably responded to SFPP's argument by simply performing its statutory duty to pass on the reasonableness of SFPP's rates, rather than dwelling on the difficulty of the task at hand. Assuming FERC's decision to find the rates just and reasonable was reasoned, it does not become unreasoned simply because FERC reached its decision without explicitly commenting on its difficulty. In any event, it is apparent from the length and complexity of FERC's discussion that it understood the complexity of SFPP's case.

As for SFPP's argument that it could not have predicted the eventual rates, the Commission expressly responded to that reliance argument by stating that SFPP was on notice that its rates were subject to review, and that "there was a risk that the rates could be found unjust and unreasonable and reparations awarded." Opinion No. 435, 86 FERC at 61,113.

Accordingly, the Commission engaged in reasoned decisionmaking in awarding reparations. Although certain matters were complex issues of first impression, FERC did not need to acknowledge that complexity explicitly for its decision to stand.

2. *Navajo*

Turning next to the shipper petitioners, Navajo contends that it should be awarded reparations for the two years

preceding the filing of its complaint on December 22, 1993. As noted above, the Commission concluded that a prior settlement agreement between SFPP's predecessor and Navajo foreclosed Navajo from collecting reparations for this two-year period. We find no error in FERC's decision.

The settlement Navajo entered into with SFPP's predecessor, provided—in Section 2.3—that:

> For the five (5) year period following the effective date of FERC Tariff No. 88—i.e., November 23, 1988—Navajo shall not challenge, by complaint or any other means, East Line rates established or increased in conformity with the terms and conditions of this Article, nor shall they seek reparations or other damages with respect to such rates.

Southern Pac. Pipe Lines, Inc., No. IS85-15-000, Stipulation and Settlement Agreement § 2.3 (Jan. 30, 1989) (approved in *Southern Pac. Pipe Lines Partnership, L.P.*, 49 FERC ¶ 61,081 (1989)).

Navajo contends that this language permits it to seek reparations for the two years prior to filing its complaint, even though those two years are within the five-year settlement rate moratorium. In Navajo's view, this reading is compelled by the contrast between Section 2.3 and Section 1.3 of the 1989 settlement concerning West Line rates. Section 1.3 provides as follows:

> During the (5) year period following November 23, 1988 (the effective date of FERC Tariff No. 88), Navajo shall not challenge, by complaint or any other means, West Line rates established or increased in conformity with the terms and conditions of this Article, nor shall they seek reparations or other damages with respect to such rates for any part of that five (5) year period.

Id. § 1.3.

According to Navajo, the last sentence "made clear that Navajo not only agreed to refrain from filing a complaint seeking reparations during the five-year period following November 23, 1988, but also agreed to waive its rights to reparations relating to that five-year period." In contrast, Navajo argues, "the provision pertaining to the East Line did not waive the right to seek reparations for rates paid for service on the East Line during the five-year period once the moratorium expired."

The ALJ disagreed with Navajo, concluding that a "fair reading of the settlement agreement and the Commission's order approving it precludes claims for reparation by Navajo for rates charged during the period when the settlement was in effect." ALJ Decision, 80 FERC at 65,207-08. The Commission affirmed the ALJ's interpretation as "the only reasonable interpretation" of the settlement agreement. Opinion No. 435, 86 FERC at 61,111.

We find the Commission's interpretation of the settlement to be reasonable. Section 2.3 expressly provides that Navajo shall not "seek reparations or other damages" with respect to the East Line rates for the five-year period following November 23, 1988. *Southern Pac. Pipe Lines, Inc.*, No. IS85-15-000, Stipulation and Settlement Agreement § 2.3 (Jan. 30, 1989). While an additional phrase does appear in Section 1.3, this does not alter the plain meaning of Section 2.3. It is unreasonable to assume that, although obtaining agreement to language expressly referring to a five-year moratorium period for all rate changes, SFPP nevertheless intended to permit Navajo to seek reparations for two of the five years.

Navajo advances a number of theories as to why SFPP might have agreed to a shorter moratorium on East Line reparations. However, there is no evidence that these theories played any part in the negotiations and none of them address

the fundamental point that the settlement expressly says five years. The Commission's interpretation of the contract as such is therefore reasonable.

3. *Valero*

Valero, another shipper, contends that FERC erred by denying it reparations in Opinion No. 435-B. Valero argues that because FERC found that SFPP charged it unjust and unreasonable rates in Opinion No. 435-A, FERC had an obligation to award reparations to it as well. FERC responds that because Valero was not a party to OR92-8, the Commission properly rejected Valero's claim that it is entitled to reparations "in the same manner" as the shippers in OR92-8. Valero may be correct that it is entitled to reparations, but we agree with FERC that it is not so entitled in this particular proceeding.

Valero's complaint involves distinct issues from the complaints at issue in this case, and accordingly FERC reasonably denied it recovery in these proceedings. This case concerns shippers who filed their claims prior to August 1995. The timing of their complaint matters, because FERC determined that they were entitled to reparations only for overcharges during the two years preceding the filing of their complaints. In contrast, Valero—then Ultramar Diamond Shamrock—filed its complaint in November 1997. *ARCO Products Co.*, 82 FERC ¶ 61,043, 61,183 (1998). That complaint was docketed as OR98-2, separate from the docket at issue here, OR92-8, consolidated with other complaints filed after August 7, 1995, and all held in abeyance with an opportunity to amend the complaints based on the findings in this proceeding. The post-August 7, 1995 complaints were consolidated in a proceeding separate from OR92-8 because those complaints involve different test periods and cost factors from those addressed in OR92-8. Because Valero filed its complaint in 1997—and because, as FERC points out, Valero's reparations will be determined based upon a

different test period and cost factors, and will be limited to the two years prior to the filing of Valero's complaint—it may well not be entitled to the same reparations as shippers who filed in 1994. Accordingly, Valero must have its reparations claims adjudicated in the OR98-2 proceedings.

Valero's arguments do not convince us otherwise. Valero alleges that FERC's failure to provide reparations to Valero is directly contrary to the plain language and intent of the ICA. Under Section 8 of the ICA, injured shippers are provided a right of action for damages. *See* 49 U.S.C. app. § 8 (1988). But FERC's denial of reparations in Opinion No. 435-B is perfectly consistent with this provision. FERC did not hold in that order that Valero was not entitled to reparations. Rather, FERC deferred consideration of Valero's entitlement. Accordingly, FERC's decision is consistent with the ICA.

Valero argues that under *A.J. Phillips Co. v. Grand Trunk Western Ry. Co.*, 236 U.S. 662, 665 (1915), its party status in OR92-8 "is of no moment in awarding reparations." Pet. Joint Brief on Rate and Reparations Issues 28. While *A.J. Phillips* held that finding a rate unreasonable "inured to the benefit of every person that had been obliged to pay the unjust rate," *A.J. Phillips*, 236 U.S. at 665, 35 S.Ct. at 445, it also recognized that a shipper's right to reparations turns on the timely filing of its complaint, and its rights are limited by that complaint. *Id.* at 665-66, 35 S.Ct. at 445 ("But while every person who had paid the rate could take advantage of the finding that the advance was unreasonable, he was obliged to assert his claim within the time fixed by law"). Here, Valero—which filed its complaint in 1997—is not entitled to the same reparations as the shippers who filed in 1994, since Valero's reparations will be determined upon a different test period and cost factors, and will be limited to the two-year period prior to the filing of Valero's complaint. *See* 49 U.S.C. app. § 16(3)(b) (1988). Thus, deferring consideration of Valero's claim is consistent with *A.J. Phillips*

Co. While there is some commonality of issues between Valero's complaint proceeding and OR92-8, OR92-8 is not dispositive of Valero's reparations claims. Therefore Valero must await adjudication of its reparations claims in OR98-2.

4. *BP West Coast Products and Chevron*

Petitioners allege that because both BP WCP (formerly ARCO Products Co.) and Chevron (formerly Texaco Refining and Marketing, Inc.) were injured by SFPP's East Line rates and both jointly filed—on January 14, 1994—a complaint, FERC violated the ICA by denying them reparations. FERC denied both of these entities damages from the East Line rates because they stated no claim regarding the East Line rates in their complaints. We again agree with FERC.

ARCO's and Texaco's complaint simply did not challenge the East Line rates. While their complaint referenced Tariff No. 15 along with other tariffs, which includes East Line rates, that reference was not specific to any rate, but alleged only that shippers shipped petroleum pursuant to one or more of those tariffs. That vague reference fails to state a cognizable complaint against the East Line rates, since otherwise the allegations solely concerned West Line rates. ARCO's and Texaco's complaint alleged, instead, that their "shipments basically originate in California and are transported by SFPP to Phoenix and Tucson." Transportation from California into Arizona occurs only on the West Line. Consistent with that allegation, the complaint addressed the grandfathering of the West Line rates, and sought reparations, at the least, from the date of the filing of their complaint, which is the standard for grandfathered rates. The affidavit submitted in support of the complaint concluded that "SFPP's rates on its West Line System exceed the rates that would result from an appropriate application of the Commission's ratemaking methodology by a significant amount." *SFPP, L.P.*, No. OR92-8-000, Affidavit of Marsha K. Palazzi 2

(Jan. 18, 1994). No mention of the East Line rates is made in the complaint or the supporting affidavit. Thus, the complaint was only applicable to the West Line rates. *See SFPP, L.P.*, 68 FERC at 61,582. Under these circumstances, the Commission reasonably interpreted the complaint to state a claim only with regard to the West Line rates, and BP WCP and Chevron were properly denied reparations for the East Line rates.

ARCO's October 2, 1992, intervention in OR92-8 does not change this result, *see* Rate Br. 32, since BP WCP's stated ground for intervention was its "direct interest" in the "new origin point and applicable rates at East Hynes." As the East Hynes station is on the West Line, this intervention likewise stated no claim with regard to the East Line rates.

5. *Chevron*

On September 23, 1992, Chevron filed a protest concerning SFPP's reversal of the flow of the "six-inch line" between Tucson and Phoenix, and SFPP's modification of its prorationing policy. On August 3, 1993, Chevron filed a complaint alleging that SFPP's East Line rates were unjust and unreasonable. Chevron demanded reparations "for the period beginning two years preceding the filing of the Complaint."

The Commission properly calculated Chevron's East Line rate reparations based on Chevron's 1993 complaint challenging those rates. *See supra* at 14 n. 2. While Chevron argued that its 1993 complaint should relate back to its 1992 protest, the 1992 protest did not challenge the East Line rates, but rather only challenged flow reversal on one of SFPP's lines and its capacity allocation procedures.

Chevron now contends that its East Line reparations should be based upon the date of its 1992 protest because the Commission treated the protest as a complaint. The Commission, held, however, that "[t]he scope of the complaint

proceeding shall be defined by the issues raised by El Paso and Chevron which caused these proceedings to be instituted." *SFPP, L.P.*, 63 FERC ¶ 61,275, 62,769 (1993). Chevron's protest "complained against the reversal of one of SFPP's lines and its capacity allocation procedures, but did not complain against the East Line rates as such." Opinion No. 435-A, 91 FERC at 61,514 n.55. Because the protest did not complain about the East Line rates, the Commission properly found that the protest did not trigger reparations for the East Line rates, and dated Chevron's right to reparations from Chevron's August 3, 1993, East Line complaint. *SFPP, L.P.*, 97 FERC ¶ 61,138 61,623-24 (2001) (citing *SFPP, L.P.*, 65 FERC ¶ 61,028); *see also SFPP, L.P.*, 102 FERC ¶ 61,073, 61,183-84 (2003).

The ALJ's determination that reparations demands could relate back to earlier-filed complaints does not aid Chevron. As the ALJ recognized, an amendment to a pleading may relate back when it arises out of the same transaction or occurrence set forth in the original pleading. Fed. R. Civ. P. 15(c)(2). Because the Commission found that Chevron's original protest did not concern the East Line rates, but rather only the practice of prorationing and reversal of the "six inch line," however, Chevron's claim for East Line rate reparations cannot relate back to that protest. The Commission reasonably determined that Chevron's 1993 complaint, which first stated a claim with regard to the justness and reasonableness of the East Line rates, was the proper basis for determining Chevron's right to reparations.

For the reasons given above, we affirm the decisions of the Commission in awarding reparations and deny the petitions for review in full to the extent they challenge FERC's reparations order.

CONCLUSION

In conclusion, we affirm the decisions of the Commission and deny the petitions except as follows: As regards the West Line rates, we grant the petition and remand with respect to the Commission's decisions that the Watson enhancement and turbine fuel rates are grandfathered under the EPAct. We also remand with respect to the Commission's determination that changes in tax allowance policy constitute "substantially changed circumstances" under the Act. As regards the East Line rates, we reverse the Commission's decision to rely on *Lakehead* insofar as it pertains to tax allowances, and thus grant the petition and remand the Commission's determination regarding the proper tax allowance for SFPP. We also grant the petition and remand for the Commission to determine and explain an appropriate allocation of the civil litigation costs between the West Line and East Line shippers. Finally, we grant the petition and remand for the Commission to address SFPP's request to recover its reconditioning costs.

APPENDIX B

FEDERAL ENERGY REGULATORY COMMISSION
[¶ 61,022]

SFPP, L.P.m, Docket Nos. OR92-8-000, OR93-5-000, OR94-3-000, and OR94-4-000

Docket No. OR95-5-000

MOBILE OIL CORPORATION

v.

SFPP, L.P.,

Docket No. OR95-34-000

TOSCO CORPORATION

v.

SFPP, L.P.,

Opinion No. 435;
Opinion and Order on Initial Decision

(Issued January 13, 1999)

Before Commissioners: JAMES J. HOECKER, *Chairman*, VICKY A. BAILEY, WILLIAM L. MASSEY, LINDA BREATHITT, and CURT HEBERT, JR.

[Opinion No. 435 Text]

An initial decision issued in the captioned dockets that addressed the reasonableness of SFPP, L.P.'s (SFPP) rates for the transportation of various petroleum products from California and Texas to points in Arizona and New Mexico.[1] That decision concluded that the East Line rates between Texas and Arizona were not just and reasonable and ordered them to be modified and directed SFPP to make reparations accordingly. The initial decision also held that the complainants shipping on the West Line between California and Arizona had not met the jurisdictional standard for oil pipeline rate cases contained in the Energy Policy Act of 1992 (the EPAct),[2] and that therefore SFPP's West Line rates would continue to be deemed just and reasonable.

The Commission affirms the bulk of the initial decision while modifying and clarifying a number of rulings related to jurisdictional and cost-of-service issues. SFPP is directed to recalculate and refile its East Line rates to comply with this order. Any revised East Line rates developed pursuant to this order will be effective March 1, 1999. SFPP is directed to calculate the potential reparations, but the Commission will defer its decision on whether reparations must be made pending review of the compliance filing.

I. Background

A. *Regulatory Framework*

This is the first oil pipeline rate case to be decided under the provisions of the EPAct, enacted on October 24, 1992. The more important provisions of the EPAct included the "grandfathering" of certain rates that were not subject to protest, investigation, or complaint during 365 days prior

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[1] *SFPP, L.P.*, 80 FERC ¶ 63,014 (1997).

[2] Public Law 102-486 (1992), enacted October 24, 1992, codified as 42 U.S.C. § 7172 (1994)).

to the enactment of the EPAct,[3] a requirement that such rates may be modified only if a complainant establishes substantially changed circumstances,[4] and modified provisions for reparations for complaints meeting the jurisdictional standards of the EPAct.[5]

After this proceeding began, the Commission initiated rulemaking proceedings to modify its regulations governing oil pipeline rate filings and complaints, including regulations governing the type of information required to justify such filings. This case also involves oil pipeline rate issues such as the starting rate base, its capitalization and amortization, the allocation of costs among different regions or zones, and cost-of-service issues such as the cost of capital, litigation, repair, and retirement expenses, and tax allowances.

B. *SFPP and its Operations*

SFPP owns a pipeline system that transports refined petroleum products in six Western and Southwestern states: Texas, New Mexico, Arizona, California, Nevada, and Oregon.[6] This proceeding involves SFPP's interstate rates, practices, and terms and conditions of service on its "South System," which consists of pipe and other facilities used to transport refined petroleum products into Arizona from El Paso, Texas (the "East Line") and from the Los Angeles, California area (the "West Line").[7] A map of the South System is attached as Appendix A.

The West Line consists of a 24-inch pipeline from Watson Station to Norwalk, California, a combination 20-inch and 24-inch pipeline and a 16-inch pipeline from Norwalk to

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[3] Section 1803(a) of the EPAct.

[4] Section 1803(b) of the EPAct.

[5] *Id.*

[6] Exh. 142 at p. 9.

[7] Exh. 144 at p. 3.

Colton, California, a 20-inch pipeline and a 12-inch pipeline from Colton to Phoenix, Arizona, and a 6-inch pipeline from Phoenix to Tucson, Arizona. The East Line consists of parallel 8-inch and 12-inch pipelines between El Paso and Tucson and one pipeline (at various points 8- or 12-inches) between Tucson and Phoenix. SFPP also operates an enhancement facility at its Watson Station, in California. The Watson Station enhancement system, installed in 1994 after negotiations with its shippers, consists of vapor collection piping connected to tanks and related vapor collection facilities that allow SFPP to operate its tanks at a higher pressure than that previously used on it systems.[8]

SFPP, whose rates are at issue in this proceeding, is a limited partnership that was organized on December 19, 1988, under Delaware law.[9] SFPP succeeded to the assets of its predecessor company, Southern Pacific Pipe Lines, Inc. ("SPPL"), which was the original owner and operator of the South System, and was owned by the Santa Fe Pacific Corp.[10] The tariff rates for movements over the East and West Lines into Phoenix were equal from the pipeline's inception in 1956 until 1985.[11] In 1985 SFPP's predecessor filed equalized tariff increases to reflect capital expenditures undertaken on the West Line to increase capacity into Phoenix. This filing was protested by certain East Line shippers, including Navajo Refining Company ("Navajo"), which objected to paying any rate increase attributable to capital improvements on the West Line.[12]

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[8] *Id.* at pp. 12, 14.

[9] *See* 80 FERC at p. 65,118 and Exh. 142 at p. 5 for the details of SFPP's relation to its parent and affiliated companies.

[10] Exh. 142 at p. 8; Tr. 8125.

[11] Exh. 142 at p. 11; *see also* Tr. 8128-29.

[12] Exh. 142 at p. 12; Tr. 8129.

The Commission terminated the 1985 rate proceeding by approving two settlement agreements reached by the pipeline and the protesting shippers. The first settlement, filed on July 6, 1988, was approved on November 17, 1988,[13] and the second, dealing only with Navajo's issues, was filed on January 30, 1989, and was approved on October 19, 1989.[14] Both settlements rolled back the South System rate increases from those filed in 1985, effective November 24, 1988, provided for refunds based on those lower rates through the settlement dates, and for the first time established a rate differential for movements into Phoenix on the East and West Lines. The rates challenged in this proceeding are those established by the two settlements.[15]

Under these settlements, SFPP completed several expansion projects on both its East and West Lines during the late 1980s and early 1990s and increased its rates as permitted under the settlement agreements.[16] Two West Line expansion projects increased capacity to 173,000 barrels per day into Phoenix from Los Angeles at a cost of about $140 million. As part of those expansion projects SFPP reinstituted West Line service from Phoenix to Tucson over its 6-inch line.[17] The West Line expansion project was completed in January 1989, and the related rates were increased at that time.[18]

The East Line expansion project was undertaken in two phases. In Phase I, completed in February 1992, SFPP made facility modifications at Tucson and it increased pumping

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[13] *See Southern Pacific Pipe Lines, Inc.*, 45 FERC ¶ 61,242 (1988).

[14] *See Southern Pacific Pipe Lines Partnership, L.P.*, 49 FERC ¶ 61,081 (1989).

[15] Exh. 142 at pp. 13-14.

[16] *Id.*; Tr. 8131; *see* Exh. 147 at pp. 6-14.

[17] Exh. 147 at pp. 7-9; *See also* Exh. 863 at 45.

[18] *See* 49 FERC ¶ 61,081 (1989).

capacity at a cost of approximately $4 million. In Phase II, SFPP replaced forty miles of 8-inch pipe between Tucson and Phoenix with 12-inch pipe and constructed more breakout tanks at Tucson at a cost of approximately $20 million. The East Line expansion project increased capacity between El Paso and Tucson to 95,000 barrels per day, and between Tucson and Phoenix to 55,000 barrels per day.[19]

During Phase II of the East Line expansion project SFPP reversed and then re-reversed its 6-inch line between Tucson and Phoenix. The 6-inch line had been in West Line service from Phoenix to Tucson since completion of the West Line expansion in 1989, but was under-used during 1990 and early 1991. To serve its customers during Phase II of the East Line expansion project, SFPP reversed the 6-inch line in August 1991 to operate in East Line service from Tucson to Phoenix.[20] SFPP returned the 6-inch pipeline to West Line service upon completion of Phase II of the East Line expansion at the end of August 1992.[21] At that time, SFPP began to carrying out the terms of an agreement it had made with ARCO Products Company ("ARCO"). The Reversal Agreement obligated SFPP to dedicate the 6-inch line to West Line service for five years, with possible renewals for three additional five-year periods. ARCO agreed to ship an annual volume of 1.825 million barrels of product from Phoenix to Tucson (based on a 5,000 barrels per day commitment) or to pay SFPP damages in the form of equivalent revenues.[22] ARCO did not renew the Reversal Agreement when it expired in 1997.

The litigation involved here was engendered by disputes between SFPP and its shippers, and among its shippers,

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[19] Exh. 147 at p. 10.

[20] Exh. 147 at pp. 9-10.

[21] *Id.* at p. 11.

[22] *Id.* at pp. 15-17; *see also* Exh. 119 (ARCO Reversal Agreement).

regarding the allocation of costs among the various expansions and services, the overall level of SFPP's rates, the jurisdictional status of the Watson Station enhancement facilities, and whether the details of the ARCO Reversal Agreement and the obligation of SFPP's to publish its pro-rationing policy in its tariff.

C. *Procedural History*

This proceeding was initiated on September 4, 1992 when El Paso Refinery, L.P. ("EPR") filed a pleading styled "Protest or, Alternatively, Complaint" with the Commission.[23] EPR alleged, among other things, that SFPP's proration policy[24] and the re-reversal of the direction of flow of the 6-inch line between Phoenix and Tucson adversely affected its business, and that SFPP's existing East Line rates should be reduced.[25] On September 29, 1992, the Commission's Oil Pipeline Board ("Board") suspended SFPP's tariffs for one day and set them for investigation.[26]

On December 31, 1992, SFPP filed FERC Tariff No. 18 to provide its West Line shippers with the service of transporting turbine (or jet) fuel to Tucson. EPR and Chevron USA Products Co. ("Chevron") protested Tariff No. 18, arguing

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[23] No shipper protested SFPP's FERC Tariff Nos. 15, 16 and 17, filed on July 31, 1992, which added a new West Line origin point at East Hynes, California.

[24] The term "proration" refers to the allocation of pipeline capacity among shippers during periods when the aggregate volume of petroleum products which shippers nominate for transportation exceed the capacity of the pipeline.

[25] This complaint was filed before October 24, 1992, and therefore is not subject to the grandfathering provisions of the EPAct. The Commission granted Refinery Holding Company, L.P. ("RHC") party status as the successor in interest to EPR following EPR's bankruptcy. *SFPP, L.P.*, 65 FERC ¶ 61,028 (1993), *reh'g denied*, 66 FERC ¶ 61,210 (1994).

[26] *SFPP, L.P.*, 60 FERC ¶ 62,252 (1992).

that it raised many of the same issues that were pending in proceeding begun on September 29, 1992, and that the rate for the turbine fuel contained in Tariff 18[27] was unjust and unreasonable. On January 29, 1993, the Board suspended Tariff No. 18 for one day subject to refunds, instituted an investigation under Section 15(7) of the ICA, and consolidated the cases.[28]

SFPP filed exceptions to both of the Board's September 29. 1992, and January 29, 1993 orders. On April 2, 1993, the Commission vacated the original suspension orders and the refund obligations,[29] holding that the case should go forward as a complaint proceeding limited to the issues raised by EPR, Chevron and the intervenors. The Commission concluded that allegations about the unlawfulness of SFPP's past and existing practices with respect to flow reversal, prorationing, and current rates, should be adjudicated under Section 13(1). The April 2, 1993 order also placed the burden of proof on the complainants to prove the challenged rates were not just and reasonable since SFPP had not proposed to modify those rates.[30]

Chevron and Navajo filed requests for rehearing. The Commission issued two Orders on Rehearing in response. In the first, issued June 18, 1993, the Commission reaffirmed its ruling vacating the Board's suspension order and imposition

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[27] The rate for the turbine fuel was the same rate previously filed in the predecessor Tariff Nos. 15, 16, and 17.

[28] *SFPP, L.P.*, 62 FERC ¶ 62,060 (1993).

[29] *SFPP, L.P.*, 63 FERC ¶ 61,014 (1993).

[30] *Id.* at pp. 61,124-25. On June 14, 1993, EPR sought to amend its complaint by adding claims for reparations. Over SFPP's objection, on September 10, 1993, the presiding administrative law judge ruled that EPR's complaint would be amended back to September 4, 1992, and that EPR could seek reparations for the period beginning two years prior to that date. This point is now moot as to EPR.

of refund obligations. The Commission reiterated its conclusion that the protests addressed in the Commission's September 29, 1992 and January 29, 1993 orders were in the nature of complaints, and that the burden of proof was on the complainants. The Commission terminated the suspension dockets and stated that the proceedings would proceed in the complaint docket, OR92-8-000.[31] On August 3, 1993, Chevron filed its complaint against the West Line rates.

On October 5, 1993, the Commission issued a further rehearing order in response to the rehearing requests filed by EPR, Chevron, Navajo and SFPP. The Commission first reiterated its prior conclusion that none of the protests had challenged anything that SFPP had proposed to change in the filings addressed by the September 29, 1992 and January 29, 1993 orders.[32] With respect to grandfathering of SFPP's rates, the Commission agreed with SFPP that nothing in the initial protests filed by EPR and Chevron challenged SFPP's West Line rates, and therefore found those rates had been deemed just and reasonable under Section 1803(a) of the EPAct, pending resolution of the complaint.[33] The Commission therefore held that Chevron must establish substantially changed circumstances under Section 1803(b) of the EPAct as a condition for litigating whether SFPP's West Line rates are unlawful as it had challenged rates that had not previously been in effect. The order therefore affirmed the dismissal of Chevron's protest of Tariff No. 18, holding that the relevant protest could not apply to rates that were not modified when the tariff was filed.[34] The October 5 Order also affirmed

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[31] *SFPP, L.P.*, 63 FERC ¶ 61,275, at p. 62,789 (1993).

[32] *SFPP, L.P.*, 65 FERC ¶ 61,028, at p. 61,376 (1993).

[33] *Id.* at p. 61,378.

[34] *Id.* On November 4, 1993, Chevron filed a third petition for rehearing, this time challenging the Commission's October 5 Order. The Commission denied that request on February 17, 1994. *SFPP, L.P.*, 66 FERC ¶ 61,210 (1994).

SFPP's right to present market-based evidence while noting that at that point SFPP had no intention to do so.

Additional complaints were filed on December 22, 1993, by Navajo (challenging SFPP's East and West Line rates) and on January 14, 1994, jointly by ARCO Products Co. and Texaco Refining and Marketing Inc., both of whom challenged SFPP's West Line rates. In its answers SFPP acknowledged that Navajo need not meet the requirement of establishing a substantial change in the economic circumstances because Navajo was contractually barred from filing a compliant during the 365 day period proceeding the October 24, 1992 effective date of the EPAct.[35] SFPP asserted, however, that other parties could not "piggy-back" on Navajo's complaint and challenge the West Line rates without establishing substantially changed circumstances. On April 20, 1994, the Commission held that the filing of Navajo's complaint removed the grandfathering protection from SFPP's West Line rates and that ARCO, Texaco and Chevron therefore need not establish substantially changed circumstances.[36] However, in response to SFPP's request for rehearing of that ruling, the Commission reversed its April 20 Order concluding that the plain meaning of the language of Section 1803 required Chevron and ARCO/Texaco to meet the substantially changed circumstances standard.[37] Petitions for rehearing of that order were denied on September 16, 1994.[38]

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[35] *See* Section 1803(b)(2) of the EPAct.

[36] *SFPP, L.P.*, 67 FERC ¶ 61,089, at p. 61,255 (1994). The Commission further held that any reparations with respect to SFPP's West Line rates could be prospective only, starting from the date of the filing of each complaint. *Id.*

[37] *SFPP, L.P.*, 68 FERC ¶ 61,105, at p. 61,581 (1994).

[38] *SFPP, L.P.*, 68 FERC ¶ 61,306 (1994).

Further complaints were filed against Tariff Nos. 15, 16, 17, and 18 by Mobil on August 3, 1995, and by Tosco on August 7, 1995, and were consolidated with the instant proceeding.[39] Since that date several additional complaints have been filed against SFPP.[40] In each case the Commission held the complaints in abeyance pending the outcome of the decision in this proceeding. Thus, the instant order only addresses the consolidated complaints that were filed through August 7, 1995.

The hearing began in 1993, and pursuant to an ALJ order, SFPP filed a Cost and Revenue Study in February 1994, setting forth unadjusted results for 1993. The complainants filed written direct testimony in June of 1994 and the Commission staff did so in August. SFPP's responsive testimony was filed in April 1995, and all rebuttal testimony in August 1995. SFPP moved to strike those portions of the Staff's and complainants' testimony that included updated test year information, or alternatively, for leave to file surrebuttal testimony responding to the parties' testimony. The

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[39] These complaints were filed after SFPP filed its responsive testimony, and therefore Mobil and Tosco were required to accept the record as it stood when they filed their complaints. *Mobil Oil Corp. v. SFPP, L.P.*, 73 FERC ¶ 61,032 (1995); *Tosco Corp. v. SFPP, L.P.*, 74 FERC ¶ 61,056 (1996)

[40] The complaints that have not been consolidated with the instant proceedings are: Docket Nos. OR96-2-000, OR96-10-000 (75 FERC ¶ 61,292 (1996)), and OR96-17-000 (77 FERC ¶ 61,033 (1996)), as consolidated; Docket Nos. OR96-15-000 (77 FERC ¶ 61,191 (1996)) and OR97-2-000 (78 FERC ¶ 61,047 (1997)) held in abeyance pending the decision in OR92-8-000, *et al.*; and Docket Nos. OR98-1-000, OR98-2-000 (82 FERC ¶ 61,043 (1998), and OR98-13-000 (84 FERC ¶ 61,139 (1998)), as consolidated, and held in abeyance pending the decision in OR92-8-000, *et al.* Any party that made a timely filing to intervene and was not formally listed in the Commission's orders in these proceeding will be admitted in the separate order addressing the future of these proceedings.

ALJ granted SFPP's alternative motion and permitted SFPP to file surrebuttal testimony, and allowed the other parties sur-surrebuttal testimony. The hearing commenced on April 9, 1996, and lasted until July 19. Briefing was competed November 16, 1996.

During the hearing, SFPP and EPR reached an agreement to settle all issues raised in EPR's complaint, pleadings and testimony filed in this proceeding, provided that the agreement would not prejudice the rights of other parties.[41] After the conclusion of the hearing, Navajo withdrew its complaint against SFPP's West Line rates, subject to the condition that Navajo's withdrawal would not prejudice the rights of other parties.[42] Navajo remained as a complainant against SFPP's East Line rates. The initial decision issued on September 25, 1997. Six parties filed briefs on exceptions on December 5, and briefs opposing exceptions on January 23, 1998.

D. *The Initial Decision*

The 100 page initial decision addressed 38 major issues the ALJ consolidated into thirteen sections, each organized around several related issues. The details of the ALJ rulings and the related exceptions filed are discussed below.

II. Discussion

This discussion follows a somewhat different organizational structure than the initial decision. The first section addresses all basic jurisdictional issues establishing whether the Commission will entertain the parties' arguments, the second addresses the rate design issues that determine how costs are to be allocated among the different sections of SFPP's pipeline, the third section addresses various operating and capital issues, the fourth addresses the scope of repara-

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[41] *SFPP, L.P.*, 76 FERC ¶ 63,018 (1996).

[42] *See SFPP, L.P.*, 80 FERC ¶ 63,014 (1997) and *SFPP, L.P.*, 80 FERC ¶ 61,088 (1997).

tions, and the fifth addresses the publication of prorationing policies. A sixth addresses the content of the compliance filing to this order and an overview of procedures pertinent to the remaining complaint proceedings involving SFPP.

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D. *Reparations*

The initial decision contains an extensive discussion of whether and when reparations may be available in the instant proceeding.[215] The ALJ first held that since the West Line Shippers had not shown substantially changed circumstances, they were not entitled to reparations for shipments on the West Line. The Commission has affirmed the ALJ's conclusion on substantially changed circumstances and affirms this conclusion as well. He also held that Navajo's prior settlement with SFPP barred Navajo from recovering reparations for the two year period prior to the date of its complaint. While Navajo asserts otherwise, the ALJ pointed out that the only reasonable interpretation of Navajo's 1989 settlement with SFPP is that Navajo is barred from seeking reparations for the time frame that its settlement was in effect. The Commission agrees, and on this point the ALJ's ruling is affirmed for the reasons stated in his ruling.[216]

The ALJ also held that the East Line Shippers were entitled to reparations for the two year period before the date of their complaints, except, as noted, for Navajo. The ALJ also held that the West Line shippers were not entitled to obtain reparations for shipments they made on the East Line if those rates should be determined to be unjust and unreasonable. The ALJ also ruled that shippers who had not requested reparations in their initial complaints could obtain reparations from the date of their original complaint upon filing an

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[215] 80 FERC at pp. 65,201-208.

[216] 80 FERC at pp. 65,207-08.

amended complaint.[217] The ALJ then used a test-period concept in determining the level of reparations. He concluded that once a just and reasonable rate is established to be applied prospectively, the same rate should be used to determine the level of reparations in the previous years.[218]

SFPP excepts to the conclusion that reparations may be obtained two years before the complaint if the existing rate is not grandfathered, arguing that equitable considerations are such that reparations should not be awarded for any of the rates at issue here if they should be found unjust and unreasonable. SFPP also argues that reparations cannot be obtained through an amended complaint that relates back to the date of the original complaint. Both SFPP and Chevron object to the determination that reparations should be awarded on a test year basis. They argue that the reparations for any year other than the test year should be determined based on the actual costs and revenues incurred in that year.

SFPP further argues that if reparations cover a period of several years, reparations should be made only if total revenues exceeded the total cost-of-service in the years to which the reparations would apply. SFPP claims that otherwise it would be required to absorb the losses from underrecoveries while surrendering the surpluses for the years for which there was an over-recovery. The West Line Shippers object to any determination that they may not obtain reparations for shipments that they may have made over SFPP's East Lines. The complainants also assert that reparations should be available from the date of an initial complaint, not from the date of an amended complaint first raising the reparations issue. They argue that this is consistent with federal court practice and the Commission's regulations.

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[217] 80 FERC at pp. 65,205-06.

[218] 80 FERC at pp. 65,202-203.

There is no dispute that reparations are available to some degree for shipments over the East Lines if those rates are determined to be unjust and unreasonable. The debate turns rather on which parties may be eligible for reparations and the period for which they are to awarded. Reparations have traditionally been considered an equitable remedy, and whether they are granted is a matter of Commission's discretion.[219]

Upon consideration of the relevant precedent, the Commission is affirming the ALJ's determination that reparations are available on a "relation-back" basis. The complainants assert that requiring a request for reparations to be included in the initial complaint is an anachronistic practice, while SFPP asserts that the weight of Interstate Commerce Commission (ICC) and related court authority supports this conclusion. The Commission concludes that the ICC and Surface Transportation Board have become more liberal in recent years, for example, permitting a request for reparations to relate back to the date of an informal complaint.[220] While SFPP cites to federal cases to the contrary,[221] these cases dealt with contract matters in federal court and not rate cases before a regulatory agency vested with authority under the ICA. However, as the ALJ stated, the Commission normally follows the Federal Rules of Procedure in deciding procedural issues.[222] Given the relaxation of strict forms of pleading since the Federal Rules of Procedure were adopted, the Commission will

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[219] Refunds under the Natural Gas Act are also at the Commission's discretion. Reparations are not available under the NGA since rate changes in complaint cases are only effective prospectively under Section 5 of the NGA.

[220] *See* 80 FERC at pp. 65,204-05, citing *Thompson Phosphate Co. v. Atlanta Coast Line*, 282 F. Supp. 698 (S.D.N.Y. 1968).

[221] *See* 80 FERC at p. 65,204, n.851.

[222] 80 FERC at p. 65,205, citing *Revere Petroleum Corp.*, 60 FERC ¶ 63,023, at p. 65,192 (1992).

permit reparations to be awarded back to the date of the original complaint.

The Commission also concludes that in this proceeding reparations should not be awarded for any period before the filing date of the East Line complaints. All of these complaints were filed while SFPP's 1988 settlement rates were in effect, rates that had been agreed to by the majority of the shippers using the system at the time the settlements were made. While the Commission only approved, and did not adjudicate, the settlement rates, SFPP undertook a substantial expansion of its system in reliance on those settlement rates. Until such time as the rates were called into question by the filing of the complaints, there was no reason for SFPP, or the Commission, to have grounds to believe that the settlement rates entered into with most of its shippers were not just and reasonable, or that the shippers themselves may have thought otherwise. Therefore, the Commission will not award reparations for the period proceeding any of the complaints involved in these proceedings.

For the period after the complaints were filed to the date of this decision, SFPP was on notice that its rates were the source of some considerable dissatisfaction, that they would be subject to review, and that there was a risk that the rates could be found unjust and unreasonable and reparations awarded. SFPP had the choice of litigating the rates, or attempting to reach a settlement with its shippers to resolve their disagreements. The Commission agrees with the complainants that holding that no reparations would be due in this proceeding removes much of the incentive for the pipeline to settle or to act with restraint in the litigation. The Commission also agrees with SFPP that to award reparations automatically lessens the restraint that shippers may feel in filing complaints against that pipeline, which several shippers have done repetitively. The number of unique issues involved in this proceeding and the fact that it has been protracted may

also influence how reparations should be determined. However, since the Commission does not have before it the means to estimate reparations at this time, it will take no further action then to say in general terms for what time frames reparations may be available and how the reparations that may be due in this proceeding are to be calculated.

Thus, the period for reparations will commence from the date of each complaint until March 31, 1999, the effective date of any revised East Line rates required by this order. To calculate the potential reparations, SFPP shall develop an East Line cost-of- service for the test year 1994, design a rate that reflects that cost-of-service and conforms to this order, and index the rate so designed to December 31, 1998. Utilizing the indexed rates thus developed, SFPP will apply those rates to the design volumes adopted by this order for each calendar year for which an indexed rate has been developed, thus establishing a new cost-of-service for each of the subsequent years. Thereafter, for each of the five years 1994 to 1998, and the partial year 1999 through February 28, 1999, SFPP shall determine whether the revenues for each subsequent period resulted in over—or underecovery of its cost-of-service for each of those years. For any reparations that may be due for the years prior to 1994, SFPP shall develop a separate cost-of-service applying the rulings stated in this order and shall determine whether it over—or underrecovered its cost-of-service in those years. As stated earlier, no reparations will be due for periods prior to the filing date of a complaint.

SFPP may also develop, as supplementary cost items for each such year, additional costs or cost factors that the Commission concluded were not to be included in the 1994 test year cost of service, but which were actually incurred in the years 1995 through 1998. Such costs may include litigation, settlement, reconditioning, and environmental expenses as actually incurred, not as estimated or accrued. Any such

costs must be reflected as a separate line item for the year involved and be supported by SFPP's regulatory reports and work papers. SFPP may also include a PBOP allowance for time periods for which there was an external trust fund conforming to the Commission's policies. SFPP shall show a separate revised net income figure for each of the five years 1994-1998 to reflect any such additional costs. Any of the additional cost claims shall be fully supported by work papers and accounting records that should be available to all parties and the Commission.

The Commission concludes that the final amount of reparations due should be calculated on a total cost-of-service basis for the period for which the reparations are due. Since the proper cost-of-service has been at issue for several years and SFPP was entitled to defend its existing rates, the Commission does not believe that it is equitable to require SFPP to make reparations for the years in which it may have overrecovered its cost of service, and to absorb the losses in which it underrecovered its cost of service. Prospectively, as a matter of normal rate design practice, SFPP is at risk for the underrecoveries and may keep any overrecoveries pending action in another rate case; moreover, if the underrecoveries are protracted, SFPP may file for a rate increase. This symmetry is maintained if SFPP is permitted to net out the fat and lean years that may occur during the time frame for which reparations may be due. Therefore, SFPP's final calculation will be to net out its over- and underrecoveries for each year and determine that net amount, if any, that is due its East Line shippers.

* * *

IV. Remaining Procedural Issues and Conclusions

The Commission has determined that the West Line Shippers, Mobil, TOSCO, and ARCO have not proven substantially changed circumstances as of the dates of their com-

plaints against SFPP's West Line rates in these consolidated proceedings. Therefore those complaints are dismissed and the proceedings are closed. Since the last of the consolidated complaints was filed on August 7, 1995, the issues of substantially changed circumstances on SFPP's West Line and the reasonableness of the West Line rates are closed through the date of the last complaint. Thus, with the exception of a further complaint by Navajo, any complaint filed against SFPP's West Line rates filed after August 7, 1995 must establish substantially changed circumstances as of the date of that complaint in a manner that is consistent with this order. The Commission will elaborate in a separate order the procedures to be followed in evaluating the series of complaints filed against SFPP's rates subsequent to August 7, 1995.

The Commission has also found that some of the theories with which SFPP has sought to defend its East Line rates were not justified on this record. Thus, to the extent that the current level of SFPP's East Line rates depends on those theories or arguments, they may not be just and reasonable, and to that extent modifications to the related cost elements are required. This in turn may reduce SFPP's cost-of-service for 1994 below the rates that were in effect during that year. SFPP is therefore directed to recalculate its East Line rates for the year 1994 in a manner consistent with this order. In its compliance filing SFPP must state the recalculated rate, how the rate was devised, and must provide supporting memorandum work papers, and estimate reparations, if any, in the manner discussed earlier in the order. Both the compliance filing and any comments must be supported by specific citations to this order and to the portions of the record upon which any party relies in its filing.

Finally, if SFPP believes that any revisions to its East Line rates that may result from this order are too low to recover its costs as of the effective date of the revised rates, it may make a filing to raise the rates to a higher level at the time it makes

its compliance filing to this order. SFPP will have the burden of establishing that any such new or refiled rate is just and reasonable under the ICAct and that its proposal is consistent with the findings of this order.

The Commission orders:

(A) The complaints against SFPP's West Line in this consolidated proceeding are dismissed. The dismissal of those complaints is without prejudice to complaints that may have been filed against SFPP's West Line rates after August 7, 1995.

(B) SFPP's East Line rates may not be just and reasonable for the year ended December 31, 1994 for the reasons stated in this order. Within 30 days after this order issues SFPP shall file revised tariffs reflecting the changes to the calculation of its East Line rates required by this order for the years 1994, 1995, 1996, 1997, and 1998, as indexed to a current level pursuant to the Commission's indexing regulations published at 18 C.F.R. § 342.3, with any prospective East Line rates to be effective March 1, 1999. SFPP shall estimate any reparations that may be due as required in the body of this order.

(C) If, based on the compliance filing required by paragraph B, SFPP's East Line rates are determined to be just and reasonable, the complaints against the East Line rates will be dismissed for all complaints filed before August 7, 1995. If the East Line rates are determined not to be just and reasonable pursuant to paragraph B, the Commission will determine at a later date whether reparations should be made based on the compliance filing required by paragraph B.

(D) SFPP's base rates for the indexing of its West Line rates shall be those in effect on October 24, 1992, and for the indexing of its East Line rates, those established as of the effective date of this order if the compliance filing discloses that the rates on the East Line must be modified. Otherwise,

the base rates for the indexing of its East Line rates shall be those in effect as of October 24, 1992.

(E) SFPP must file a tariff reflecting the current charges for its Watson Station drain dry facilities within 30 days after this order issues.

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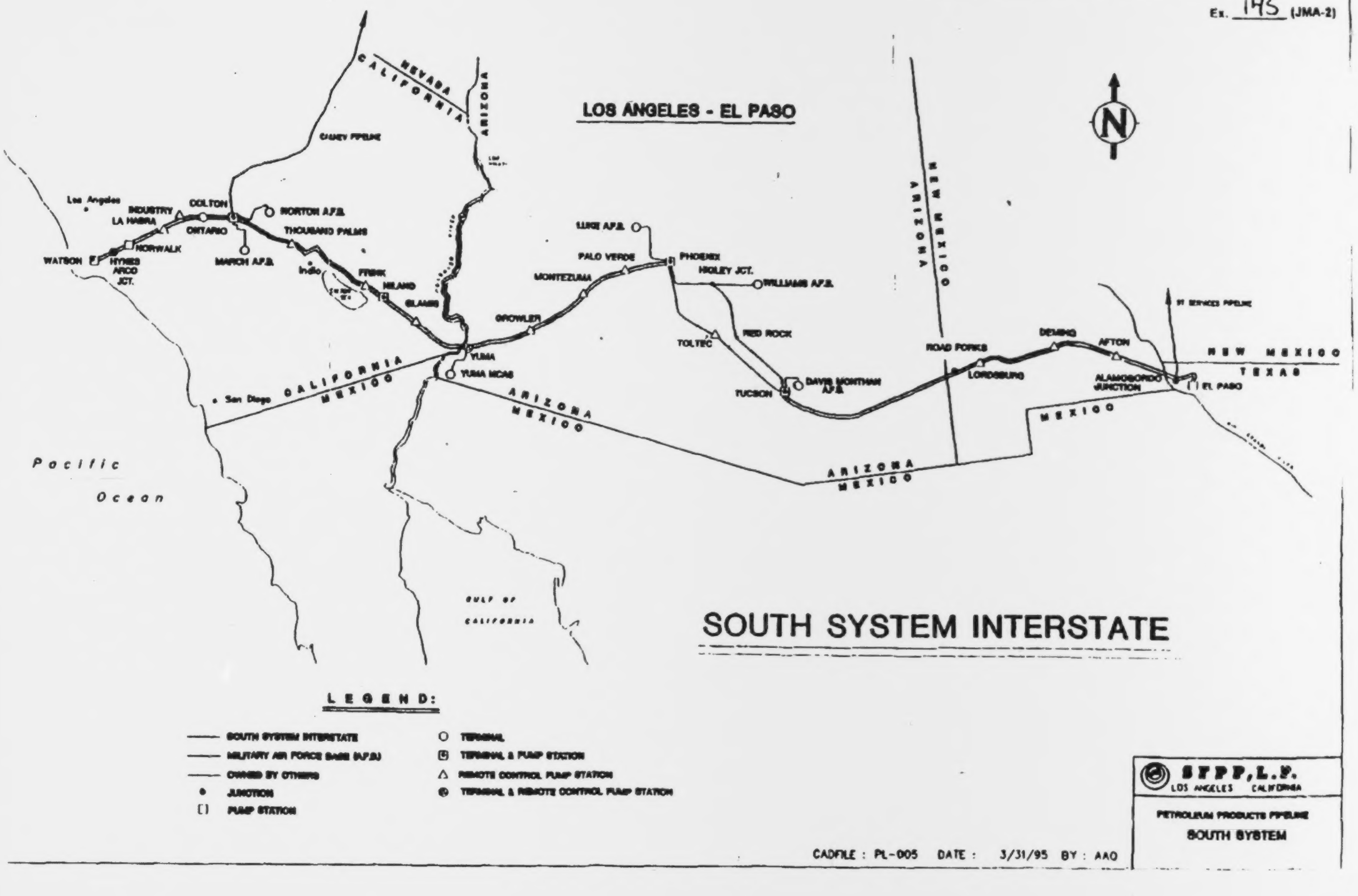
APPENDIX A

Ex. 145 (JMA-2)



FEDERAL ENERGY REGULATORY COMMISSION
[¶ 61,056]

SFPP, L.P., Docket No. IS99-144-000

Order Accepting and Suspending Tariff Filing

(Issued April 14, 1999)

Before Commissioners: JAMES J. HOECKER, *Chairman*, VICKY A. BAILEY, WILLIAM L. MASSEY, LINDA BREATHITT, and CURT HEBERT, JR.

On March 15, 1999, in response to Opinion No. 435,[1] SFPP, L.P. (SFPP) filed FERC Tariff Nos. 43 and 44 in Docket No. IS99-144-000 with a proposed effective date of April 1, 1999. The Commission accepts and suspends proposed FERC Tariff Nos. 43 and 44, effective April 1, 1999, subject to refund, to the outcome of the ongoing proceeding in SFPP, L.P., *et al.* Docket No. OR92-8-001, *et al.*, and to SFPP correcting the statement of its proration policy, as discussed below.

Background

Opinion No. 435 required SFPP to file revised tariffs which reflect changes to its proration policy and its East Line[2] tariff rates within 30 days of the date of that order. On January 28, 1999, SFPP filed an unopposed motion for an extension of time to prepare the compliance filing in Docket No. OR92-8-001, *et al.* until March 15, 1999, and requested that any prospective rate changes be made effective April 1, 1999. The Commission granted this request on February 1, 1999,

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[1] *SFPP, L.P. et al.*, 86 FERC ¶ 61,022 (1999).

[2] The pipeline transportation route from El Paso, Texas, to Lordsburg, New Mexico, to Tucson, Arizona, and to Phoenix, Arizona.

and SFPP timely filed both the compliance filing and the instant filing on March 15, 1999. In addition, the date for filing of comments responding to the compliance filing was extended to April 26, 1999.

SFPP states that FERC Tariff No. 43 reflects the required changes in SFPP's East Line rates and also modifies Item 35 (Proration of Pipeline Capacity). FERC Tariff No. 44 is a charge for volumetric rate deficiencies at Watson Station, a gathering enhancement facility in California.

Intervenor Motions and Protests

Motions to intervene and protests to the instant tariff filing were due March 30, 1999. All timely motions for intervention are granted pursuant to Rule 214 of the Commission's regulations. Motions for leave to intervene in the instant filing were filed by ARCO Products Company, a Division of Atlantic Richfield Company (ARCO) and Tosco Corporation (Tosco) on March 30, 1999, and one day out-of- time by Mobil Oil Corporation (Mobil) on March 31, 1999. The Commission grants the motion as late intervention will not unduly delay this proceeding or prejudice other parties.

ARCO and Tosco, collectively referred to herein as Indicated Shippers, also filed a protest of the proposed volumetric rate deficiency charge for the Watson Station facilities contained in FERC Tariff No. 44. Indicated Shippers states that this charge has not been proven to be a cost-based rate and has not otherwise been proven to be a just and reasonable rate.[3]

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[3] Prior to filing its protest in the captioned docket, Refinery Holding Company, L.P. (RHC) filed a "Motion for Order Requiring SFPP Immediately to Submit a Revised Compliance Filing, and Request For Expedited Consideration" to the March 23, 1999 compliance filing SFPP had previously made in Docket No. OR92-8-001, *et al.* RHC's objection asserted that the compliance filing would include in FERC Tariff No. 43 three East Line tariff rates including certain litigation and settlement costs used to

RHC states that SFPP has disregarded the major rulings in Opinion No. 435 despite the extension of time to make the compliance filing, and requests that the Commission require SFPP to submit a revised compliance filing immediately.

Discussion

The Commission concludes that SFPP must modify Item 35 of FERC Tariff No. 43 dealing with SFPP's proration policy if it is to comply with Opinion No. 435. SFPP correctly states it has included in Item 35 a statement that refers to a more detailed prorationing policy, and tells where the statement can be obtained, and indicates the minimum notice period (45 days) for shippers to be notified of any changes, all of which complies with Opinion No. 435.

However, if a party attempts to access SFPP's prorationing policy at the Internet address listed in Item 35 (it can also be obtained by mail or phone request), the detailed prorationing policy does not have its own caption but is located within the "Nominations and Schedules" section of the Internet page. There is no separate section titled "Proration Policy" which can be readily identified. In addition, the effective date of the proration policy is not indicated in the website version if the reader only reviews the document as it appears on the screen. The effective is otherwise only visible if the Internet page is actually printed out instead of only being reviewed on the screen.

In its order in Amoco Pipeline Company[4] issued February 6, 1998, the Commission stated:

> Consistent with our holding in *Total v. Citgo*, it is not necessary that Amoco include all the details of its prorationing policy within its tariff. However, in order to

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derive the East Line rates, which it claims would make the tariff rates unjust and unreasonable.

[4] 82 FERC ¶ 61,108, at p. 61,386 (1998).

> provide shippers with notice of any change in its prorationing policy, Amoco must identify in its tariff the prorationing policy document by both *title and effective date*. Any future changes in the underlying prorationing document must be noticed by *refiling the tariff* to correct the title and effective date of the change in the policy. (emphasis added)

Therefore, SFPP must have a prorationing policy document with a title and effective date which can be readily referenced and located. This document can then be referenced, redated and/or replaced as necessary without confusion as to which version of the policy is currently effective. Also, the additional information that is located in the "Nominations and Schedules" section in SFPP's Internet website, but which is not in SFPP's tariff, along with any other information affecting tariff rules and regulations, must also be referenced in SFPP's tariff. SFPP must amend its tariff and supporting detailed prorationing statement accordingly.

Finally, because of the ongoing investigation and review of the proposed rates in the compliance filing, the proposed tariff rates in both tariffs in the instant filing cannot be determined to be just and reasonable until review of the compliance filing in Docket No. OR92-8-001, *et al.* is complete. Thus, while the Commission is ruling at this time on the portions of the filing related to SFPP's prorationing policy since those are not dependent on rate calculations, the balance of the filing will be accepted and suspended, subject to the outcome of the Docket No. OR92-8-001, et al. RHC's issues will not be considered at this time but will be addressed in the merits ruling on the compliance filing in Docket No. OR92-8-000, *et al.*

The Commission orders:

(A) The Commission accepts and suspends proposed FERC Tariff Nos. 43 and 44, effective April 1, 1999, subject to refund, and to the outcome of the ongoing proceeding in

SFPP, L.P., Docket No. OR92-8-001, *et al.*, and the conditions below.

(B) Within 15 days after this order issues, SFPP must revise the tariff and non-tariff language relating to its prorationing policies, as discussed in the body of this order.

FEDERAL ENERGY REGULATORY COMMISSION
[¶ 61,135]

SFPP, L.P., Docket Nos. OR92-8-000, OR92-8-009, OR93-5-000, OR93-5-006, OR94-3-000, OR94-4-000 and OR94-4-006

Docket Nos. OR95-5-000 and OR95-5-004

MOBIL OIL CORPORATION

v.

SFPP, L.P.,

Docket No. OR95-34-000

TOSCO CORPORATION

v.

SFPP, L.P.,

SFPP, L.P., Docket Nos. IS99-144-000 and IS99-144-001

Opinion No. 435-A;
Order on Rehearing Requests and Compliance Filings
(Issued May 17, 2000)

Before Commissioners: James J. Hoecker, Chairman, William L. Massey, Linda Breathitt, and Curt Hebert, Jr.

[Opinion No. 435-A Text]

On January 13, 1999, the Commission issued an order addressing the reasonableness of SFPP, L.P.'s (SFPP) rates on its east and west lines serving Arizona and New Mexico.[1] SFPP filed two compliance filings on March 15, 1999, one in the main docket[2] and one in Docket No. IS99-144-000. SFPP filed a request for rehearing in both dockets and two other parties filed requests for rehearing in the main docket. The Commission grants rehearing in part and denies it in part. Having previously accepted and suspended the compliance filing in Docket No. IS99-144-000, the Commission will accept the compliance filing in the main docket subject to certain modifications required by its rulings on the rehearing requests and an opportunity for further comment on certain of the cost figures that will be included in the revised filing.

I. Background

The factual background of this proceeding is discussed in detail in the January 13, 1999 Order and that detail will not be repeated here. As explained there, SFPP owns a pipeline system that transports refined petroleum products in six Western and Southwestern states: Texas, New Mexico, Arizona, California, Nevada, and Oregon.[3] This proceeding involves SFPP's interstate rates, practices, and terms and conditions of service on its "South System," which consists of pipe and other facilities used to transport refined petroleum products into Arizona from El Paso, Texas (the "East Line") and from the Los Angeles, California area (the "West Line").[4]

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[1] *SFPP, Inc.*, 86 FERC ¶ 61,022 (1999) (Opinion No. 435).

[2] In this order the main docket encompasses Docket No. OR92-8-000 and all the other dockets listed in the caption except Docket No. IS99-144-000.

[3] Exh. 142 at p. 9.

[4] Exh. 144 at p. 3.

The rates for the East and West Lines have been in litigation since 1992. Pursuant to the provisions of the Energy Policy Act of 1992 (EPAct),[5] the Commission found that the West Line rates were, with one exception, grandfathered rates.[6] The Commission therefore examined the concept of substantially changed circumstances under the EPAct as the basis for challenging the grandfathering of the West Line rates,[7] and concluded that the parties complaining against the West Line rates had not established that there were substantially changed circumstances to the economic basis of those rates.[8] The Commission therefore dismissed the complaints pending against the West Line rates for the period November 1992 through August 7, 1995. The Commission did permit certain complaints, which were filed against the West Line rates after that date, to be amended in light of the conclusions in Opinion No. 435.[9] Several amended complaints against the East and West Lines, as well as new complaints against the rest of SFPP's system, were filed on January 10, 2000, and are addressed in a contemporaneous order.

The East Line rates had been determined not to be grandfathered.[10] Therefore the Commission addressed the reasonableness of the East Line rates on the merits. The Commission clarified several issues related to the Opinion No. 154-B methodology for establishing oil pipeline maximum rates.[11] These included the starting rate base, its capital structure, its

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[5] Section 1803(b) of the EPAct, Pub. L. No. 102-486, 106 Stat. 2772 (1992).

[6] 86 FERC at pp. 61,061-62.

[7] *Id.* at pp. 61,064-67.

[8] *Id.* at pp. 61,067-78.

[9] *Id.* at p. 61,061.

[10] *Id.* at pp. 61,059-60.

[11] *Williams Pipe Line Company*, Opinion No. 154-B, 31 FERC ¶ 61,377, at pp. 61,834-35 (1985).

amortization, the calculation of the deferred equity component, the accumulated deferred income taxes, allowance for funds used during construction, and the accumulated depreciation. The Commission also made findings on such conventional cost of service issues as projected volumes, SFPP's cost of capital, income tax allowances, litigation expenses, power costs, reconditioning expenses, environmental costs, and post-retirement benefits other than pensions (PBOPs). The third major topic was the method for calculating the reparations to be paid to any eligible East Line shippers. The Commission also concluded that SFPP did not have to publish the detailed provisions of its pro-rationing policies in its tariff as long as those details were readily available from the carrier. The Commission required SFPP to make compliance filings consistent with its findings. The specifics of each finding relevant to the filings are reviewed below.

II. The Requests for Rehearing

Requests for rehearing were filed by SFPP, Chevron Products Company (Chevron), and Navajo Refining Company (Navajo). ARCO Products Company and its related parties who challenged SFPP's West Line rates did not file requests for rehearing, but filed appeals in the U.S. Court of Appeals for the D.C. Circuit.[12]

* * *

D. Reparations

The prior order did not make any final determinations regarding reparations, leaving such determinations to be made once the compliance filing was made and the scope of any reparations was clearer. However the Commission did provide certain guidelines. First, it held that Navajo's settlement barred any reparations for the period the settlement was in effect. The Commission also held that no reparations would

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[12] *ARCO v. FERC*, Nos. 99-1062.

be paid for the period before the complaints were filed.[54] The Commission further concluded that SFPP could net out reparations over the years for which they might be due and established a procedure for determining what amounts might be due. Finally, the Commission stated it would allow SFPP to propose an offset of any reparations due by unrecovered litigation, environmental, and pipeline recoating costs that might be due in the same period. Each of these determinations is challenged on rehearing.

* * *

F. Rehearing of the Compliance Filing in Docket No. IS99-144-000

On March 15, 1999, in response to Opinion No. 435,[65] SFPP filed FERC Tariff Nos. 43 and 44 in Docket No. IS99-144-000 with a proposed effective date of April 1, 1999. The Commission accepted and suspended the proposed tariffs, effective April 1, 1999, subject to refund, to the outcome of the ongoing proceeding in SFPP, L.P., et al. Docket No. OR92-8-001, *et al.*, and to SFPP's correcting the statement of its proration policy. On rehearing, SFPP argues that the suspension of the revised tariffs was improper because both were rates that were prescribed by the Commission. It argues that when a rate has been prescribed by the Commission, it is the lawful rate and thereafter no refunds or reparations lie against the rate. It therefore requests that the Commission remove the refund obligation now attached to Docket No. IS99-144-000.

The Commission will deny rehearing in part and grant rehearing in part. Tariff No. 43 reflects the new East Line rates and pro-rationing policy required by Order No. 435. While Opinion No. 435 contained instructions on how to de-

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[54] *Id.* at p. 61,111.

[65] *SFPP, L.P., et al.*, 86 FERC ¶ 61,022 (1999).

sign those rates, the calculations were complex and several were challenged when the rates were filed. At the time Tariff No. 43 was filed there was a significant chance that the rate levels in the tariff would change depending on how the protests and related requests for rehearing were resolved. Therefore the suspension obligation will not be lifted as to Tariff No. 43.

Tariff No. 44 was filed to comply with the requirement that SFPP file a tariff equal to the charge it has made for the use of the enhancement facilities. Opinion No. 435 concluded that charge was grandfathered through August 7, 1995, the effective date of the findings required by Opinion No. 435. Because the charges for the use of the enhanced facilities were grandfathered through that date by the provisions of the EPAct, the charge is presumed to be just and reasonable. Therefore no refunds or reparations are due provided that the charge was accurately filed. While the various complainants are opposed to the charge and its level, they have not represented that the rates for use of the Watson Station enhancement facilities do not accurately reflect the charges that were collected prior to the enactment of the EPAct. Since no refund obligation can attached to a just and reasonable rate, the refund obligation is lifted with respect to Tariff No. 44.

* * *

The Commission orders:

(A) Rehearing is granted and denied as stated in the body of this order.

(B) The compliance filing in Docket No. IS99-144-000 is accepted and the refund obligation previously attached to that filing is lifted.

(C) SFPP shall make a revised compliance filing in Docket Nos. OR92-8-000 though OR95-34-000 consistent with this order within 60 days after this order issues, to be effective April 1, 1999.

FEDERAL ENERGY REGULATORY COMMISSION
[¶ 61,281]

SFPP, L.P., Docket Nos. OR92-8-000, OR92-8-010, OR93-5-000, OR93-5-007, OR94-3-000, OR94-4-000, OR94-4-007

OR95-5-000, OR95-5-006

MOBIL OIL CORPORATION

v.

SFPP, L.P.,

OR95-34-000

TOSCO CORPORATION

v.

SFPP, L.P.,

SFPP, L.P., IS99-144-000, IS99-144-001, IS99-144-002

SFPP, L.P., IS00-379-000
OPINION NO. 435-B

(Issued September 13, 2001)

OPINION ON REHEARING AND DIRECTING REVISED COMPLIANCE FILING

Before Commissioners: PAT WOOD, III, *Chairman*; WILLIAM L. MASSEY, LINDA BREATHITT, and NORA MEAD BROWNELL

On May 17, 2000, the Commission issued Opinion No. 435-A,[1] an order on rehearing in the captioned proceeding that modified and clarified certain portions of its prior order in Opinion No. 435.[2] Both orders addressed the method for establishing just and reasonable rates for SFPP Inc.'s (SFPP) east and west lines serving Arizona and New Mexico based on a 1994 cost of service. In response to Opinion No. 435-A, SFPP filed a revised compliance filing in Docket No. OR98-010, *et al.*, on July 17, 2000. On the same date SFPP also filed proposed FERC Tariff Number 60 in Docket No. IS00-379-000 to provide revised rates reflecting the compliance filing, and included a surcharge on its East Line rates between El Paso, Texas, and Phoenix, Arizona, to recover certain additional costs the Commission stated SFPP might be eligible to amortize over a 5-year period. Both the July 17 compliance filing and the filing in Docket No. IS00-379-000 were protested. On August 16, 2000, the Commission accepted and suspended proposed Tariff Number 60, subject to refund, effective August 1, 2000.[3]

SFPP and two shipper parties, Chevron Products Company (Chevron), and Refining Holding Company (RHC) have filed requests for rehearing of Opinion No. 435-A. SFPP filed a rehearing request related to the August 16, 2000 suspension order.[4] The Commission denies SFPP's requests for rehearing, certain of those of the shipper parties, and clarifies a number of issues. In light of those decisions and upon review of the compliance filing, SFPP is directed to submit a revised

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[1] *SFPP, L.P.*, 91 FERC ¶ 61,135 (2000) (Opinion No. 435-A).

[2] *SFPP, L.P.*, 86 FERC ¶ 61,022 (1999) (Opinion No. 435).

[3] *SFPP L.P.*, 92 FERC ¶ 61,166 (2000).

[4] The parties have since filed a number of procedural motions addressing the time frame and reparation issues addressed by this order. None of these merit further consideration than the merits discussion of reparations issues in the body of this order.

compliance filing in Docket No. OR92-8-000, *et al.* and to recalculate and refile the surcharge filed in Docket No. IS00-379-000. SFPP is directed to make reparations consistent with this order.

Discussion

The background of this complex litigation is discussed in detail in Opinion Nos. 435 and 435-A and will not be repeated here except as necessary to resolve the issues presented. In summary, the litigation involves a protracted dispute between SFPP and its shippers regarding the reasonableness of SFPP's oil pipeline rates for shipments on its South Line system. That system consists of lines between the Los Angles basin and Phoenix, Arizona, and between El Paso, Texas, and Phoenix. In addition, the system has the capability to serve Tucson, Arizona from either of its end points. The rehearing and compliance issues now before the Commission turn primarily on rate base issues, the recovery of legal costs, and the eligibility for and calculation of reparations. A related point regards the extent to which SFPP can recover through a surcharge certain costs that the Commission did not permit SFPP to recover through its rate base but may be eligible for recovery through a five year surcharge under Opinion No. 435-A.

A. *The Requests for Rehearing*

* * *

3. *Reparation Issues*

In the prior orders the Commission established the just and reasonable rates for SFPP's East Lines for the calendar year 1994 based on a 1994 costs of service. Because those rates were established pursuant to complaints, the rates established by the prior orders became effective on August 1, 2000, the date that the Commission accepted SFPP's compliance filing. The East Line rate levels as of August 1, 2000 were devel-

oped by determining what the rates would be on that date after applying the oil pipeline cost adjustment factors under the Commission's oil pipeline regulations to the 1994 cost of service. To the extent that certain of SFPP's costs could not be recovered by the offset against possible reparations that were not actually paid in years after 1995, the Commission also stated that those costs could be recovered through a five year surcharge effective on August 1, 2000.[29]

Reparations are due when complainant shippers paid more for East Line transportation service between January 1, 1994 and August 1, 2000 than the just and reasonable rate the Commission established for the calendar year 1994, beginning with the dates of their complaints. The difference between the 1994 rate level and the level actually paid by those shippers in the intervening period through August 1, 2000 represents the amount that SFPP earned above the just and reasonable rate established for the calendar year 1994. Since the 1994 cost of service is being indexed, this results in a different rate level for the prevailing East Line shippers for each year between 1994 and August 1, 2000, and a different level of reparations in each such year based on the date of their complaints. The large number of potential calculations materially complicates the issues to be decided here. In addition, the ICA also provides that reparations are available for up to two years before the filing of a complaint if the rates paid in those two prior years exceed the just and reasonable rate established in this proceeding. Because indexing was not in effect prior to 1995, the 1994 rates cannot be indexed retrospectively.

As a threshold matter, Opinion No. 435-A held that only those East Line shippers who had filed complaints could receive any reparations that might be due under that order,[30] a

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[29] 91 FERC at 61,516-17.

[30] *Id.* at 61,154.

basic ruling not challenged here, and that only Navajo Refining Company met the standard. Chevron and RFC filed requests for rehearing asserting that they have had complainant status since the early part of this proceeding. A review of the record establishes that the Commission's order in these proceedings dated October 5, 1993, accepted Chevron's complaint in Docket No. OR93-5-000 and consolidated it with this proceeding, Docket No. OR92-8-002.[31] The same order granted RFC complainant status as a successor in interest to El Paso Refinery Company in the same dockets.[32] SFPP did not contest these conclusions. The Commission will grant rehearing.

Moreover, as the case caption indicates, Tosco was a complainant in the instant proceeding on that date and a review of the underlying pleadings indicates that Tosco clearly complained against the reasonableness of SFPP's East Line rates.[33] Tosco raised this point in its comment on the compliance filing, and the Commission concludes that Tosco is entitled to reparations of any shipments on SFPP's East Lines between August 7, 1995, the date of its complaint, and the August 1, 2000, and for a two year period before August 7, 1995. Similarly, Mobil filed a complaint dated April 3, 1995, as amended on June 12, 1995, that also challenged the reasonableness of SFPP's East Line rates.[34] While SFPP questioned whether the Tosco and Mobil complaints were adequate under the EPA, the Commission accepted the complaints and set them for hearing.[35] The Commission con-

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[31] *SFFP, L.P.*, 65 FERC ¶ 61,028 at 61,379 (1998).

[32] *Id.*, 61,380.

[33] *See* Tosco's August 7, 1995 complaint in Docket No. OR95-34-000 at 8-10.

[34] *See* Mobil's June 12, 1995 amended complaint in Docket No. OR95-5-000 at 6.

[35] *Mobil Oil Corporation v. SFPP*, 73 FERC ¶ 61,032 (1995).

cludes that these two complainants are also entitled to reparations.

One additional party, Ultramar, asserts in its comments on the compliance filing that it is also entitled to reparations for its shipments on the East Line after 1994 because it filed complaints against the East Line rates in 1997 and subsequent years. Because the rates it paid in 1997 exceeded the rate levels ultimately determined to be reasonable for 1994, Ultramar concludes that reparations are due it for the years between 1994 and the date SFPP's new East Line rates became effective on August 1, 2000.

Ultramar's argument for reparations fails because its November 1997 complaint against the East Line rates was filed after August 7, 1995, the last date that complaints were consolidated into this proceeding. Therefore, Ultramar is not a complainant in this proceeding and is not eligible for reparations here. The complaints filed for the period after August 7, 1995 are currently before an ALJ, and the reasonableness of those rates, and any reparations that may be due, will be established in those proceedings. As is explained in greater detail below, the parties filing complaints after August 7, 1995, will not be precluded from obtaining an award, including reparations, pursuant to another timely filed proceeding. Ultramar may not receive reparations at this time.

On rehearing and in the compliance filings, Tosco, Ultramar, and Navajo again question whether SFPP should be permitted to recover certain supplemental costs for the years 1994 through 1998 by means of an offset against reparations that might otherwise have been available in those years. They assert that this prejudices their rights to refunds for the periods after August 7, 1995, and that the Commission should not have ruled in the SFPP rate proceeding now before it that shippers filing complaints after August 7, 1995 are not eligible for reparations in the years that they filed complaints.

Upon further review, the Commission concludes that there is some merit to these arguments. Therefore the Commission will clarify Opinion No. 435-A to assure that its prior ruling does not prejudice the ability of complaining shippers to recover reparations if they prevail in the subsequent proceedings. As has been previously discussed, Opinion No. 435-A established the just and reasonable rate for the years 1994 and subsequent years, as indexed through August 1, 2000, for the complaints at issue here. However, the Commission has not determined a cost of service for the East Line for the years after 1994 based on the cost factors that were actually involved in those subsequent years.[36] Therefore the Commission has made no merits decision regarding what the just and reasonable rate level should be in each of the subsequent years for shipments that are subject to the complaints after August 7, 1995. As the cost and revenue factors that would be used for determining a just and reasonable rate could be different in each of these later years, there is no record basis here for determining the level of the just and reasonable rates for subsequent years based on a cost of service for those years. The Commission therefore concludes that it would be inequitable to preclude parties filing timely complaints against the East Line rates after August 7, 1995 from litigating the cost of service of each of the subsequent years, and therefore complaints may lie against the East Line rates for the years after August 7, 1995.[37]

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[36] No additional complaints were filed until 1996, and thus 1996 is the first year for which SFPP's East Line cost of service can be challenged by complaint. The cost of service of the two prior years might have to be adjusted to calculate reparations.

[37] This issue is also *pending on rehearing* of the Commission's September 26, 2000 decision in *ARCO Products*, *supra*. If an East Line shipper has received the benefit of the 1994 cost of service in the subsequent years, then that shipper must meet the Commission's standing requirement that there be a substantial divergence between in the cost of

The protesting parties also assert that any reparations that might otherwise have been due shippers in the years 1994 through August 1, 2000 should not be used as an offset against certain costs that the Commission did not permit SFPP to include in its embedded cost of service. In the preceding paragraphs the Commission has ruled that complainants who filed against the East Line rates after August 7, 1995 should not be precluded from obtaining relief under those complaints. This means that if the complainants should prevail, they could be awarded reparations from the date of their complaints to the date of any subsequent Commission order, and for a period two years back from the date of the complaint. The Commission clarifies that the fact that SFPP must use any revenues that flow from rates that exceed the just and reasonable level to offset certain other costs will also not prejudice the rights to reparations under complaints filed in the subsequent years.

Thus, in calculating reparations, as explained in Opinion No. 435-A, SFPP must determine what the just and reasonable rate would be in each year between 1994 and August 1, 2000 (as well as two years back from the date of the earliest complaint), and then calculate what the appropriate gross revenues would have been from that rate. The difference between the gross revenue under the new just and reasonable rate creates the total reparations pool. SFPP would then calculate the reparations due each eligible shipper (including interest), leaving a residual in the pool of funds that could not be distributed because certain shippers had not filed a complaint within the time frame of this proceeding. The residual pool would then be credited against the total supplemental costs permitted under Opinion No. 435-A between 1995 and 1998. Any remaining allowable costs would then be recov-

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service and the change in the index in the subsequent years if a Commission established rate is to be reviewed.

ered through a five year surcharge beginning on August 1, 2000.

As noted, the ruling here is without prejudice to the rights of the complainants filing against the East Line rates after August 7, 1995 to receive reparations under the subsequent complaints. If reparations should be due, they would be awarded in due course in the additional proceedings now at hearing before the Commission. The Commission is adopting this solution because its does not deem it equitable to both permit SFPP to keep refund amounts that are not paid pursuant to Opinion No. 435-A, and also file for a five year surcharge for certain costs that were not included in its 1984 cost of service. This solution prevents that inequity while preserving the rights of subsequent complainants.

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B. *The Compliance Filing*

SFPP made a filing on July 17, 2000 to comply with the provisions of Opnion No. 435-A. On the same date SFPP filed proposed FERC Tariff 60 in Docket No. IS00-379-000. Tariff 60 contained rates designed to implement the compliance filing and also to institute a surcharge to recover certain additional costs the Commission stated SFPP might be able to recover under the terms of Opinion No. 435-A. Navajo filed a timely motion to intervene and protest on July 31, 2000. On August 16, 2000, the Commission issued an order accepting and suspending proposed Tariff 60 to be effective August 1, 2000, subject to refund, and requiring SFPP to submit certain supporting information that was not included in its July 17 filing.[43] In response, SFPP filed additional information with the Commission on August 31, 2000.

On August 7, 2000, Texaco Refining and Marketing, Inc. (Texaco) and ARCO Products Company, a Division of At-

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[43] *SFPP, L.P.*, 92 FERC ¶ 61,166 (2000).

lanta Richfield Company, filed for late intervention. These two interventions are unopposed. On August 15, 2000, Ultramar Diamond Shamrock Corporation filed a late motion for intervention and a protest, and on August 21, 2000, Tosco Corporation did also. Both companies assert that they did not receive notice of SFPP's compliance filing and that they would be directly impacted by the rates contained in Tariff 60. On August 31 and September 5, 2000, SFPP filed objections to the late interventions of Ultramar and Tosco respectively. SFPP asserts that Opinion No. 435-A was a matter of common knowledge, that the interventions are long after the main docket was instituted, and that the intervening parties should not be permitting to relitigate issues that had already been addressed in Opinion No. 435-A.

The Commission will grant the four proposed late interventions. All four of these firms are shippers on SFPP's East Lines and will be directly affected by the rates proposed in Tariff 60. As such, they should be permitted an opportunity to comment on the compliance filing and surcharge calculations that underlie that tariff though they will lack standing to challenge the substance of Order No. 435-A.

1. *Rate Base Issues*

Navajo raises two issues in its protest regarding SFPP's amortization of its rate base. It first asserts that SFPP did not use the proper time frame for the amortization of its starting rate base. It further asserts that SFPP did not use the proper starting date for the amortization of part of its accumulated deferred income tax (ADIT) liability.

Navajo notes that the Commission held in Opinion No. 435-A that SFPP should amortize its starting rate base write up over "the composite useful life of the pipeline's assets as of December 31, 1983."[44] It asserts that SFPP did not apply

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[44] 86 FERC at 61,090.

this method but used the Commission's estimate of 20.6 years to amortize the rest of its rate base. Navajo argues that there was no basis in the record for this estimated useful life, and that in fact the remaining useful life is 16.8 years. It submits an affidavit of one Mr. Horst who notes that the ratio of net carrier property to gross carrier property on December 31, 1983 was 44.50 percent, *i.e.*, that some 55.50 percent of the property had already been depreciated, and that the composite depreciation rate for 1984 was 2.65 percent. Dividing the two numbers results in a remaining useful life of 16.8 years, or a completion of the amortization period of around October 16, 2000. It suggests first that SFPP should be required to make the proper calculation, and remove the starting rate base component from its rate case in this instance. The Commission concludes that Navajo has correctly calculated the amortization period for SFPP's starting rate base and that the rates should be recalculated accordingly. SFPP must use the 16.8 year time frame for the remaining amortization of its starting rate base.

A secondary issue is whether the starting rate base component should continued to be included in SFPP's costs for the rates that were effective August 1, 2000. The Commission finds that it is not appropriate to continue to include in SFPP East Line rates a rate component that will be obsolete under its own terms within some three months after the new rates became effective on August 1, 2000. The Commission therefore directs SFPP to remove the SRB cost from its base rates as of August 1, 2001, and to include that cost as a one time charge in the invoices that have been issued for the months in which it would have otherwise been effective. The current posture of this proceeding permits this to be done in an administratively efficient manner. Since the costs have already been billed under the rates that became effective, subject to refund, on August 1, 2000, SFPP must refund that portion of the rates that have already been collected for the

months to which the SRB would no longer apply. SFPP must make an appropriate revised compliance filing.

The third rate base issue involves SFPP's proposed amortization of its deferred accumulated income tax liability. Navajo asserts that Opinion No. 435 held that under the Commission's *Lakehead* doctrine,[45] partnership pipelines are permitted to include an income tax allowance in their rates only for that portion of the enterprise that is owned by interests that incur a corporate income tax liability on their share of the partnership income.[46] Navajo asserts that this shift from a whole to a partial income tax allowance results in an excessive ADIT balance because the deferred taxes would have to be calculated against a lower amount of total income taxes. It notes that Opinion No. 435 required this ADIT balance to be amortized using the *South Georgia* method. Navajo states that SFPP did establish a line in its compliance filing to make the necessary adjustment (Schedule 13, line 5), but improperly began the amortization in 1988. Navajo asserts that since the Commission did not require SFPP to adjust its income tax allowance before 1992, the amortization of the excessive ADIT should not begin until that year. Navajo is correct and SFPP must modify its compliance filing accordingly.

2. *Application of the Lakehead Doctrine*

Opinion No 435-A affirmed on appeal that SFPP was subject to the *Lakehead* doctrine and that SFPP must modify its cost of service to eliminate any tax allowance related to non-corporate owners unless it could establish that such entities were subject to double taxation. In its compliance filing SFPP states that the tax allowance contained therein was

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[45] *Lakehead Pipe Line Co.*, Opinion No. 397, 71 FERC ¶ 61,338 (1995), *order on reh'g*, Opinion No. 397-A, 75 FERC ¶ 61,181 (1996), discussed at 91 FERC pp. 61,508-10.

[46] *Citing*, 86 FERC at 61,093.

based on the list of unit holders contained in Exhibits No. 477 and 478. It did not, however, specifically list in the compliance filing the unit holders upon which the compliance filing relies. It further states that the corporations listed in its unit holder list are not categorized by whether those corporations have Subchapter C or Subchapter S status. It asserts that the unit holder corporations listed in the cited exhibits are unlikely to be Subchapter S corporations because of the restrictions on such corporations for earning passive income.

The intervening parties assert that SFPP has not adequately established which units holders were the basis for the calculation of its income tax allowance and whether those unit holders were in fact subject to double taxation. The Commission agrees that in its revised compliance filing SFPP should list the corporate unit holders that were the basis for its compliance filing, and certify to the best of its knowledge that these are not Subchapter S corporations. The remaining unit holders are to be excluded from the calculation for the reasons stated in Opinion No. 435-A.

3. *Civil Litigation Fees and Settlement Costs*

SFPP included in its compliance filing substantial litigation fees related to its FERC based litigation and to the civil litigation discussed earlier in this order. The protesting parties assert that these expenses are inadequately documented and that SFPP has incorrectly included in its compliance and tariff filing civil litigation and settlement costs. SFPP later provided documentation which separated the costs into FERC East Line, Civil East Line, and Other for the years 1995 through 1998 as well as a summary for the year 1999. In making its next compliance filing SFPP must clearly exclude any civil litigation costs from the claimed legal expenses used to develop any surcharges authorized under Opinion No. 435-A. It must also establish for all the years used in calculating its reparation obligations, including those prior to 1994, whether the fees and expenses permitted are FERC related

expenses and the periods to which they apply. SFPP must include in its revised compliance filing an explanation of how it has done so.

4. *The Recovery of Certain Additional Costs*

Opinion No. 435-A stated that SFPP might be permitted to recover by means of a surcharge certain additional costs that were not included in its 1994 cost of service. These included FERC regulatory expenses, as has been discussed, and litigation, environmental, and line rehabilitation costs that were incurred in the years 1995 through 1998. This determination is again protested at the compliance phase, with the protesting parties again asserting that this ruling violates the filed rate doctrine. They assert that SFPP should have filed a rate increase to cover the additional costs during the years at issue. Upon further review, the Commission concludes that SFPP should not be permitted to recover any costs that were not incurred in the 1994 cost of service test period, other than the FERC regulatory costs previously discussed in this order.

Earlier in this order SFPP was directed to make reparations to certain of its East Line shippers based on a 1994 cost of service that does not include documented costs in later years. Reparations based on the 1994 cost of service will reduce the cash-flow that was generated in those years. The problems with the recovery of additional legal costs incurred outside the 1994 test year were addressed earlier in this order by permitting SFPP to recover those costs through a five year surcharge beginning with the effective date of its revised East Line rates. This was done to mitigate the impact of costs that might have otherwise been included in SFPP's just and reasonable rates for an indefinite period based on the amount of FERC regulatory costs that were actually incurred in the test period.

SFPP has claimed no extraordinary environmental costs for the years 1995-1998. It does claim to have incurred some

$5.9 million in pipeline repair and rehabilitation costs that were expensed and not capitalized, or about $1 million per year in of costs in those four years that was not placed in its rate base. However, unlike the FERC regulatory costs, none of these were incurred in the test period.

The Commission does not believe that SFPP can be faulted for failing to file a new rate case to recover its costs during the course of this complex litigation. However, the Commission nevertheless concludes that it should not consider costs outside the test period when none of these costs were incurred in the test period or with any regularity thereafter. To allow a surcharge under these circumstances would permit SFPP to recover costs after the fact which were not eve present in the test year itself and which therefore could not be recovered in a cost-of-service rate filing. To do so after the fact raises serious questions under the filed rate doctrine. Moreover, the rates that were in effect in the years to 1994 were indexed rates under the provisions of the EPA. As such SFPP was required to demonstrate a substantial divergence between its actual cost of service and the rate resulting from application of the index in order to change the rate to one above the indexed ceiling level. SFPP failed to make this basic showing for the categories of costs that were not even present in the 1994 cost of service.

C. *Subsequent Filings*

SFPP is directed to make a revised compliance filing to be effective August 1, 2000, including revised tariff sheets that are necessary to implement this order, within 60 days after this order issues. The initial calculations of reparations for the years 1993 through 1999 for the eligible East Line shippers is to be extended to August 1, 2000, the point at which the reduced East Line rates became effective under Opinion No. 435-A. The cost of service of all of SFPP's lines is closed for the period before 1996, because all complaints against earlier years have been dismissed or resolved. The

determinations here are controlling in the ongoing litigation in Docket No. OR96-2-000, *et al.*

The Commission orders:

(A) Rehearing is granted and denied to the extent stated in the body of this order.

(B) SFPP must filed a revised compliance filing and revised tariffs, including revised estimates of reparations and refunds, complying with this order within 60 days after this order issues, the revised tariffs to be effective August 1, 2000.

FEDERAL ENERGY REGULATORY COMMISSION
[¶ 61,138]

SFPP, L.P., Docket Nos. OR92-8-012, OR93-5-009, OR94-3-008, OR94-4-009

OR95-5-007

Mobil Oil Corporation

v.

SFPP, L.P.,

OR95-34-006

Tosco Corporation

v.

SFPP, L.P.,

SFPP, L.P., IS99-144-004
SFPP, L.P., IS00-379-001

ORDER GRANTING CLARIFICATION AND REHEARING IN PART

(Issued November 7, 2001)

Before Commissioners: PAT WOOD, III, *Chairman;* WILLIAM L. MASSEY, LINDA BREATHITT, and NORA MEAD BROWNELL

On September 13, 2001, the Commission issued an opinion on rehearing and directing a revised compliance filing, Order No. 435-B, in the captioned dockets.[1] The Commission will clarify its prior order in three regards. The Commission's prior order in Opinion No. 435-B addressed, with finality, certain cost of service, procedural, and reparation issues related to its cost of service methodology for setting maximum oil pipeline rates. Two parties, Chevron Products Company (Chevron) and Refining Holding Company (RHC), have filed requests for clarification or rehearing of that order. The three issues raised are the effective time frame for which Chevron may be eligible for reparations, the threshold that must be met for participation in further rate proceedings involving SFPP's East Line rates, and what years may be included in the FERC regulatory cost surcharge authorized by Opinion No. 435-B. Given the extensive record in this proceeding and the parties general familiarity with the issues, this order will address their concerns while omitting the standard background section.

Discussion

The Eligibility Date For Chevron's Reparations

Chevron again asserts that it has participated as a party in litigation against SFPP's East Line rates since September 23, 1992, when it filed a protest against certain actions taken by SFPP with regard to its West Line rates. In light of this action it suggests that it is entitled to reparations for its past shipments on the East Line since the date of its September protest in Docket No. IS92-39-000.[2] However, as Chevron itself recognizes, the Commission rejected this protest as a basis for any action against the West Line rates other than the changes that SFPP actually made to the West Line rates at

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[1] *SFPP, L.P.*, 96 FERC ¶ 61, 281 (2001) (Opinion No. 435-B)

[2] *See SFPP, L.P.*, 60 FERC ¶ 62,252 (1992).

that time. Chevron was required to file a complaint in order to challenge SFPP's West and East Line rates, which it did on August 3, 1993, in Docket No. OR93-5-000. The Commission accepted this complaint on October 5, 1993.[3] Therefore Chevron's eligibility for reparations is measured from August 3, 1993, the date it filed its complaint in the instant docket.

Threshold Issues Related To Subsequent Litigation

Both Chevron and RHC request rehearing of the following statement in footnote 37 of Opinion No. 435-B:

> If an East Line shipper has received the benefit of the 1994 cost of service in the subsequent years, then that shipper must meet the Commission's standing requirement that there be a substantial divergence between in the cost of service and the change in the index in the subsequent years if a Commission established rate is to be reviewed.[4]

They first argue that, given the language of Section 343.2(c) of the Commission's oil pipeline regulations and the related explanatory language of Order No. 561-A,[5] that the need to demonstrated substantial divergence applies only to

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[3] *SFPP, L.P.*, 65 FERC ¶ 61,028 (1993).

[4] Opinion No. 435-B, slip opinion issued September 13, 2001, at 16.

[5] 18 C.F.R. §362.2(c)(1) (2001); Revisions to Oil Pipe Line Regulations Pursuant to the Energy Policy Act of 1992, Order No. 561-A, FERC Stats. & Regs. (Regs. Preambles) ¶ 31,000 at 31,104. Section 343.2(c)(1) provides in part that :

> A protest or complaint filed against a rate proposed or established under § 342.3 of this chapter must allege reasonable grounds for asserting that the rate violates the ceiling level, or that the rate increase is so substantially in excess of the actual costs incurred by the carrier that the rate is unjust and unreasonable . . . (emphasis added).

The forgoing reflects that portion of the regulation cited by RHC in its rehearing request.

oil pipeline rate cases involving grandfathered rates. RHC further argues that the substantial divergence test applies only to the portion of a rate that reflects the increase above the grandfathered rate that has resulted from the Commission's indexing procedures, and as such has no application to a challenge to the base 1994 rate at issue here. They therefore conclude that at most any subsequent challenge to SFPP's East Line rates need only show reasonable grounds to conclude that the 1994 base rates adopted in this proceeding are no longer just and reasonable in subsequent years.

The Commission will deny rehearing but grant clarification. First, as the rehearing requests correctly state, the East Line rates do not involved grandfathered rates; thus, there is no need under the Energy Policy Act of 1992 to demonstrate substantially changed circumstances to the economic basis of the rate in order to challenge those rates. However, RHC asserts that it is only necessary to show "changed circumstances" in order to warrant a new determination as to the justness and reasonableness of the lawful East Line rates established in this proceeding. They argue that this more narrow concept of changed circumstances, not a "substantial divergence" test, is the standing test that applies to the subsequent East Line rate litigation now before an administrative law judge in Docket Nos. OR96-2-000, *et al.*

The Commission has previously addressed this issue in *Calnev Pipe Line, L.L.C.*[6] In that case, the Commission held that a challenge to the indexed portion of a pipeline's rates must meet the substantial divergence test, even if the complainant was not challenging an underlying grandfathered rate.

The Commission reiterates as explained in *Calnev*, that it stated in Order No. 561, in generic terms, that "to be heard on

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[6] ARCO, a subsidiary of *BP America, Inc. v. Calnev Pipe Line, L.L.C.*, 97 FERC ¶ 61,057 (2001).

the merits, a complaint against an existing rate that has been indexed will be required to allege reasonable grounds for believing that the discrepancy between the actual cost experienced by the pipeline and the existing rate is so substantial that the existing rate is not just and reasonable."[7] The rates established in the instant case are based on the use of indexed rates after the year 1994 under the specific requirements of the Commission's prior orders in this case.[8] Regardless of the time frame in which the complaint is filed, the complainants must show that there has been a substantial divergence between the indexed rate level and the pipeline's cost of service since it is an indexed rate that they are challenging.[9] As Section 343.2 clearly states, the purpose is to determine whether the indexed rate as established or the increase(s), substantially exceeds the pipeline's cost of service Whether the rate is grandfathered is not relevant to determining when a party must show a substantial divergence between the indexed rates and the pipeline's costs. Rehearing is denied.

What Years May Be Included In The Surcharges Authorized By Opinion No. 435-B

Opinion No. 435-B stated that certain FERC regulatory costs not recovered by SFPP through the 1994 base rates could be recovered through a surcharge amortized over five years beginning with the effective date of new indexed rates established by that Opinion. The years to be included in that surcharge were 1993 and the four years 1995 through 1998.

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[7] Order No. 561 at 30,956.

[8] Opinion No. 453-B, slip op. at 13.

[9] The Commission specifically permitted the parties to file revised rate cases for all rate challenges against the East and West Lines filed after August 3, 1995 to assure that the complaining parties had a fair opportunity to respond to the procedural and substantive determinations in Opinion No. 435. *See SFPP, L.P.*, 86 FERC ¶ 61,022 at 61,117 (1999) (Opinion No. 435); *see also SFPP, L.P., ARCO Products Company v. SFPP, L.P.*, 92 FERC ¶ 61,244 (2000).

The rehearing parties question whether the year 1993 should be included in the surcharge.

The Commission concludes that the rehearing parties are correct and that SFPP's FERC regulatory costs for the calender year 1993 should not be included in the surcharge. The rate methodology to be applied to calender year 1993 for determining reparations is the just and reasonable rate methodology established for calender year 1994. Therefore any regulatory costs in 1993 are subsumed under the rate method established for the year against which reparations are measured. For 1994, the permitted method for recovery of FERC regulatory costs from the East Line shippers was 50 percent of the 1994 FERC regulatory costs amortized over 5 years, or some $300,000 per year which are applicable to the East Line rates.[10]

Applying the same approach to the year 1993 would result in any 1993 FERC regulatory costs being amortized over five years from that point, in this case some $200,000 to be amortized over 5 years beginning in 1993, as suggested by the methodology and calculations contained in SFPP's July 17 , 200 filing to Opinion No. 435-A.[11] These costs would will been fully amortized by the effective date of the rates established under Opinion No. 435 and would serve to reduce the total reparations available. They would not be included in the prospective surcharges authorized by Opinion No. 435-B. Given the consistency in approach from the ruling there is no inequity to SFPP in granting the rehearing parties' request to exclude the 1993 FERC regulatory costs from the five year surcharge that based on SFPP's 1995-1998 unrecovered FERC regulatory costs.

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[10] Opinion No. 435-B, slip op. at 14, 17-18.

[11] *See* SFPP's compliance filing dated July 17, 2000 at Schedule 30, Page 1 of 3.

The Commission orders:

The requests for clarification and rehearing are granted and denied as stated in the body of this order.

FEDERAL ENERGY REGULATORY COMMISSION
[¶ 61,177]

SFPP, L.P., DOCKET NOS. IS02-46-001 AND IS02-82-001

ORDER ON REHEARING

(Issued February 15, 2002)

Before Commissioners: PAT WOOD, III, *Chairman*; WILLIAM L. MASSEY, LINDA BREATHITT, and NORA MEAD BROWNELL

1. On December 20, 2001, the Director of the Division of Tariffs and Rates Central, acting on delegated authority, rejected tariffs involved in two compliance filings that were made by SFPP, L.P. The first tariff was Tariff No. 67, filed on November 20, 2001, in Docket No. IS02-46-000 to be effective December 1, 2001, to comply with Opinion No. 435-B.[1] The second tariff was Tariff No. 68, filed on December 14, 2001, in Docket No. IS02-82-000 to correct some of the underlying calculations involved in determining the level of Tariff No. 67. Tariff No. 68 was to be effective on December 20, 2001, and was intended to replace Tariff No. 67. The Director's letter orders rejected both tariffs on the grounds that Opinion No. 435-B required that any tariffs filed to comply with that Opinion were to be effective August 1, 2000.

2. SFPP's request for rehearing centers on the point just stated. SFPP asserts that because the Commission had previously accepted certain tariffs to be effective August 1, 2000, the Commission lacks the authority to modify Tariff No. 60 retrospectively to that date. That tariff was filed to comply

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[1] *SFPP, L.P.*, 96 FERC ¶ 61,281 (2001) (Opinion No. 435-B).

with Opinion No. 435-A,[2] a predecessor order in this case, and was accepted subject to refund.[3] The August 1, 2000 rates decreased the prior rates filed in Tariff No. 43, Docket No. IS99-144-000, to comply with Opinion No. 435.[4] Tariff No. 43 was accepted subject to refund on April 1, 1999.[5] The tariffs filed to comply with Opinion Nos. 435 and 435-A remain subject to refund at this time pending resolution of the numerous compliance issues that have been raised in the course of these proceedings. In each of the prior Opinions the Commission has made clear that SFPP must recalculate the rates to be applied in compliance with those Opinions and that any prior calculations of reparations and surcharges must be adjusted accordingly.

3. SFPP's request for rehearing argues that the Commission's directions to make any revised rates retrospective to August 1, 2000, violates the doctrine stated in *Arizona Grocery Co. v. Atchison, T. & S.F. Ry. Co.*[6] *Arizona Grocery* does not apply to the instant circumstances, however, because SFPP has been directed only to make a further compliance filing, and thus no final rate has been determined in this case.[7] This point will be further addressed in the Commission's disposition of the pending Opinion No. 435-B rehearing requests and compliance filings.

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[2] *SFPP, L.P.*, 92 FERC ¶ 61,166 (2000) (Opinion No. 435-B).

[3] *SFPP, L.P.*, 92 FERC ¶ 61,166 (2000).

[4] *SFPP, L.P.*, 86 FERC ¶ 61,022 (1999) (Opinion No. 435).

[5] *SFPP, L.P.*, 87 FERC ¶ 61,056 (1999).

[6] 284 U.S. 370, 387-90 (1932) (*Arizona Grocery*).

[7] *Arizona Grocery* could apply only if the Commission had already determined a final reasonable rate in this proceeding. The Commission then would be barred under *Arizona Grocery* from retroactively changing its determination as to that reasonable rate. The whole purpose, however, of the continuing compliance proceedings that are the subject of Opinion Nos. 435, 435-A, and 435-B is to determine what the appropriate reasonable rate should be.

4. Accordingly, rehearing of the Director's letter orders is denied. Those orders correctly rejected SFPP's tariffs for failure to comply with the explicit direction to SFPP in Opinion No. 435-B to make a revised compliance filing to be effective August 1, 2000.

The Commission orders:

Rehearing is denied.

FEDERAL ENERGY REGULATORY COMMISSION
[¶ 61,353]

SFPP, L.P., Docket Nos. OR92-8-013-015, OR93-5-010-012, OR94-3-009-011, OR94-4-010-012

OR95-5-008-010

MOBIL OIL CORPORATION

v.

SFPP, L.P.,

OR95-34-007-009

TOSCO CORPORATION

v.

SFPP, L.P.,

SFPP, L.P., IS99-144-005-007
SFPP, L.P., IS00-379-002-004, IS02-46-001, IS02-82-001

ORDER ON REHEARING, COMPLIANCE AND TARIFF FILINGS

(Issued September 26, 2002)

Before Commissioners: PAT WOOD, III, *Chairman;* WILLIAM L. MASSEY, LINDA BREATHITT, and NORA MEAD BROWNELL

1. This order addresses several compliance filings made by SFPP, L.P. (SFPP), in response to the Commission's September 13, 2001 Order issued in Opinion No. 435-B,[1] as well as several related rehearing requests. The Commission denies rehearing of the shipper parties concerns regarding reparations and SFPP's assertions regarding retroactive rate making, grants one minor request for clarification regarding the timing of reparations, and directs SFPP to file a revised compliance filing and related tariffs within 30 days after this order issues.

I. Procedural Background

2. This proceeding addresses challenges to SFPP's East Line rates between El Paso, in the east, and Tucson and Phoenix, to the west, between late 1993 and August 1, 2000. It has culminated in three decisions, Opinion Nos. 435, 435-A, and 435-B.[2] The compliance filing for Opinion No. 435 was addressed by Opinion No. 435-A, issued May 17, 2000. Opinion No. 435-A required SFPP to make an additional compliance filing to reflect certain changes to the rate methodology that had been developed in Opinion No. 435.[3] That compliance filing was made on July 17, 2000, and was addressed by Opinion No. 435-B, issued on September 13, 2001. Opinion No. 435-A also required SFPP to make a tariff filing to implement certain rate design requirements of Opinion No. 435- A. In response, SFPP filed Tariff No. 60 in Docket No. IS00-379-000, also on July 17, 2000. Tariff No. 60 involved a rate reduction to SFPP's East Line rates.[4] The Commission accepted and suspended Tariff No. 60 on August

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[1] *SFPP, L.P.*, 96 FERC ¶ 61,281 (2001) (Opinion No. 435-B).

[2] *SFPP, L.P.*, 86 FERC ¶ 61,022 (1999) (Opinion No. 435); *SFPP, L.P.*, 91 FERC ¶ 61,145 (2000) (Opinion No. 435-A); Opinion No. 435-B, *supra*.

[3] Opinion No. 435-A, 91 FERC at p. 61,498 and pp. 61,520-21.

[4] This was the first tariff filing SFPP made in this proceeding since Opinion No. 435 did not require a tariff filing.

16, 2000, to be effective August 1, 2000.[5] Tariff No. 60 was supplanted by Tariff No. 61, effective December 1, 2000, which did not revise the rates at issue here.

3. Opinion No. 435-B resulted in a number of requests for rehearing and clarification, as well as challenges to some of the directions for calculating the estimated reparations SFPP was required to prepare pursuant to Opinion No. 435-B. The Commission addressed these requests in an order issued November 7, 2001.[6] One minor request for clarification of that November 7 order will be addressed below. Opinion No. 435-B also required that SFPP revise its prior tariff filing in Docket No. IS00-379-000 (which contained Tariff No. 60) and make such revisions effective as of August 1, 2000.[7] SFPP filed Tariff No. 67 in response on November 16, 2001, in Docket No. IS02-46-000. While the filing in Docket No. IS02-46-000 was pending, SFPP advised the Commission that it had made a mistake in calculating the level of the five year surcharge included in that filing, and therefore filed Tariff No. 68 on December 14, 2001, in Docket No. IS02-82-000. Tariff No. 68 increased the level of surcharges in Tariff No. 67 and several earlier tariffs. Tariff Nos. 67 and 68 were rejected by two separate director letter orders on December 20, 2001, on grounds that they did not have an August 1, 2000 effective date as required by Opinion No. 435-B.[8]

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III. Discussion

7. This order addresses two main sets of issues. The first involves whether SFPP properly applied the methodology

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[5] *SFPP, L.P.*, 92 FERC ¶ 61,166 (2000).

[6] *SFPP, L.P.*, 97 FERC ¶ 61,138 (2001)

[7] *Id.*

[8] Unpublished Director letter orders issued by the Director, Tariffs and Rates Central, December 20, 2001.

developed in Opinion No. 435-B in making its compliance filings in Docket Nos. IS02-46-0000 and IS02-82-000. The protesting parties assert that it has not. The second set involves the date upon which any revised rates required by Opinion No. 435-B may be made effective. SFPP argues that any revised rates may not be made effective on August 1, 2000 under the doctrine stated in *Arizona Grocery Co. v. Atchison, T. & S.F. Ry. Co.*,[9] and seeks rehearing of the determination that the compliance filings made in response to Opinion No. 435-B must have an August 1, 2000 effective date.

* * *

B. The Effective Date of the Revised East Line Rates

23. The remaining issue to be addressed is the effective date of any revised rates required by this order. As has been discussed, the Commission did not accept any of the proposed East Line rates that were filed to comply with Opinion No. 435.[17] There were no rate changes to the East Line rates until the rates filed in Docket No. IS00-329-000 to comply with Order No. 435-A were accepted and suspended on August 16, 2000, to be effective August 1, 2000. Opinion No. 435-B required that any modifications to those compliance rates also be effective on August 1, 2000. SFPP has challenged this ruling as inconsistent with the requirements of *Arizona Grocery, supra*. SFPP asserts that any changes to the August 1, 2000 rates can be made only prospectively, and thus no reparations or refunds can lie for a rate reduction.

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[9] 284 U.S. 370, 387-90 (1932) (*Arizona Grocery*).

[17] The Commission did accept and suspend rates SFPP filed in relation to the so-called dry drain facilities located in California. Those rates were filed in Docket No. IS99-144-000 and were accepted and suspended subject to refund. Opinion No. 435-A lifted the refund obligation attached to those rates.

24. Under the doctrine established in *Arizona Grocery*, once the Commission has declared a maximum reasonable rate to be charged by a carrier, it cannot subsequently subject a carrier to the payment of reparations for charging that reasonable rate.[18] Here, the Commission had not declared what are the maximum reasonable rates to be charged by SFPP for its East Line services. The prior opinions issued by the Commission and the filings made by SFPP to comply with those opinions are part of the process leading to a finding of what the specific reasonable rates should be. That finding, however, has not yet been made. Thus, SFPP's argument is inapposite.

25. For this reason, the first purpose of the various opinions issued in this proceeding is to arrive at the correct methodology for establishing oil pipeline rates under the Commission's Opinion No. 154-B methodology.[19] As such, none of the prior opinions or orders in these proceedings have established a final, specific rate level that SFPP should include in any final and definitive compliance filing. In fact, it became clear after the issuance of Opinion No. 435 that the

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[18] In th[illegible] case, the Interstate Commerce Commission (ICC) made an explicit finding that the specific maximum reasonable rate would be 96.5 cents. On September 17, 1921, the carriers promulgated a rate of 96 cents, which they later voluntarily reduced to 86.5 cents. On November 3, 1922 [more than one year after the ICC order and the compliance by the carrier] certain of the complainants in the earlier proceeding, other than the petitioner, *filed a new complaint attacking the specifically stated legal rate previously established by the ICC. See* 282 U.S. at 381-82; 32 S.Ct. at 183. It is clear from the Supreme Court's decision that the failure of the Interstate Commerce Commission was to attempt to revisit its prior decision retroactively after it had fixed a specific rate, the carriers had complied, and the case was closed. The Commission did so in the context of a new complaint attacking the current rate. None of these factors is involved in the existing case, which is quite consistent with this Commission's established practice in this type of complex proceeding.

[19] *See generally* Opinion No. 435, 62 FERC at pp. 61,085-61,104.

large number of requests for rehearing and continued review of technical issues raised by comments to SFPP's first compliance filing (that to Opinion No. 435), would necessitate a further compliance filing. In Opinion No. 435-A, the Commission therefore directed SFPP to make a new compliance filing, including for the first time that SFPP prepare a set of proposed rates as part of that subsequent compliance filing.

26. There were numerous protests to the proposed rates contained in Tariff No. 60, which SFPP filed to comply with Opinion No. 425-A. In light of those protests and the resulting uncertainty regarding the rates proposed in compliance with Opinion No 434-A, which was the foundation for the tariff filing, the Commission accepted and suspended Tariff No. 60 subject to refund. Thus, it is clear that the Commission had not reached a final determination on the methodology to be used to design SFPP's East Line rates at the time it accepted Tariff No. 60 subject to refund or on the level of those rates. The fact that no final determination was made by any of these opinions is reflected in the Commission's own proposal in Opinion No. 435-A to make the rate methodology adopted in that opinion effective on the date first suggested in Opinion No. 435, namely, April 1, 1999.

27. The reason the Commission accepted the rates proposed in Tariff No. 60 subject to suspension and refund, in contrast to its action in Opinion No. 435, was out of equitable concern for the East Line shippers that are not eligible for reparations in this proceeding. Under Opinion No. 435-A, East Line shippers who were not eligible for reparations would continue to pay rates higher than those that might ultimately be determined to be just and reasonable until such time as a final and definitive prospective rate was determined. This would also be true for the shippers that were eligible for reparations, but this latter group would be protected through the ultimate receipt of their reparations. The Commission accepted the rates proposed in Tariff No. 60, effective August

1, 2000, subject to refund, in order to provide some interim rate relief to those East Line shippers who would not be eligible for reparations. This interim relief was necessitated in part because of the numerous objections to the prior orders by SFPP itself and the technical problems in SFPP's compliance filings, some of which involved clear over-reaching. These include the inclusion of FERC settlement costs in its proposed litigation costs and the refusal to offset the supplemental costs permitted against the total potential reparations pool as was clearly contemplated by Opinion No. 435-B. Under the structure adopted in the prior orders, the East Line shippers not entitled to reparations would obtain at least some rate relief during this protracted proceeding.

28. For these reasons it is clear that, given the convoluted context of this proceeding, the Commission never intended that the rates approved, subject to refund, on an interim basis in Tariff No. 60 to be final rates. In fact, the order expressly anticipated a future final determination, as follows:

> Navajo's protest raises numerous issues regarding the calculations contained in SFPP's filing. At this time there are also outstanding further requests for rehearing by SFPP, Refinery Holding Company, L.P., and Chevron Products Company (Chevron) that could materially affect the calculations [in] of SFPP's July 17 filing.. The Commission will therefore follow the practice adopted in Opinion Nos. 435 and 435-A of ruling on the requests for rehearing, the compliance filings, and a number of procedural issues related to SFPP's continuing litigation in a single order to be issued subsequent to this order.[20]

29. It is also clear from the foregoing that all parties were on notice that the Tariff No. 60 rates filed in Docket No. IS00-379-000 were not final rates, and were also on notice that those rates might be modified retrospective to the initial

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[20] *SFPP, L.P.*, 92 FERC at p. 61,564.

effective date of August 1, 2000. To argue otherwise simply ignores the clear language of the cited order and the obvious recognition by the Commission that further work would be required in these proceedings. Moreover, SFPP's argument that there can be no reparations for a rate reduction to a lawful rate initiated by the carrier is simply inapposite as that is not the issue here. The issue here is the lawfulness of the rate filed by the carrier to comply with a Commission order. As such, SFPP's argument that reparations are precluded in the context of a carrier initiated rate reduction is irrelevant since SFPP has not made an initial rate filing to reduce an established lawful rate.

30. Finally, the Commission emphasizes that its action in this case does not violate the doctrine in *Arizona Grocery*. As previously stated, there has been no final action by the Commission that establishes the rates contained in Tariff 20 as final lawful rates. This cannot occur under a situation were the Commission has expressly reserved its authority in the context of an ongoing proceeding in which the methodology for determining the rate had not even been established. This is in direct contrast to the situation that occurred in *Arizona Grocery*. SFPP's request for rehearing is denied and the new compliance filing shall be effective August 1, 2000, so that all East Line shippers will be equally affected by its terms.

The Commission orders:

(A) SFPP's request for rehearing is denied and Chevron's request for clarificatioan is granted for the reasons stated in the body of this order.

(B) The Director's rejection of the tariffs filed in Docket Nos. IS02-42-000 and IS02-82-000 is affirmed for the reasons discussed in the body of this order.

(C) SFPP is directed to make a revised compliance filing consistent with the terms of this order within 30 days after this order issues. It is also directed to file revised tariffs con-

sistent with the terms of this order, also within 30 days after this order issues. The revised tariffs are to be effective August 1, 2000. SFFP's filing must include supporting work papers consistent with the format used to make the compliance filing in Order No. 435-B.

(D) In its revised compliance filing SFPP shall calculate any additional surcharge that is due as of August 1, 2000, or any refunds that are due for the collection of the surcharge previously instituted on that date, and shall provide work papers supporting the calculation. Refunds and reparations that may be due under the revised compliance filing shall be paid to the relevant parties within 60 days of any order approving the revised compliance filing.

APPENDIX C

UNITED STATES COURT OF APPEALS,
DISTRICT OF COLUMBIA CIRCUIT

[Filed October 4, 2004]

No. 99-1020

BP WEST COAST PRODUCTS, LLC,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION AND
UNITED STATES OF AMERICA,
Respondents,

SFPP, L.P., ET AL.,
Intervenors.

CONSOLIDATED WITH 99-1051, 00-1221, 00-1240, 00-1256, 01-1413, 01-1453, 01-1469, 01-1475, 02-1008, 02-1011, 02-1321.

Before: GINSBURG, *Chief Judge*, and EDWARDS, SENTELLE, HENDERSON, RANDOLPH,* ROGERS, TATEL, GARLAND,* and ROBERTS, *Circuit Judges*.

ORDER

Upon consideration of the petition for rehearing en banc filed by petitioners-intervenors BP West Coast Products, et al., and the absence of a request by any member of the court for a vote, it is

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* Circuit Judges Henderson, Randolph, and Garland did not participate in this matter.

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:

Mark J. Langer, Clerk

BY: _____

Michael C. McGrail
Deputy Clerk

UNITED STATES COURT OF APPEALS,
DISTRICT OF COLUMBIA CIRCUIT

[Filed October 4, 2004]

No. 99-1020

BP WEST COAST PRODUCTS, LLC,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION AND
UNITED STATES OF AMERICA,
Respondents.

SFPP, L.P., ET AL.,
Intervenors.

CONSOLIDATED WITH 99-1051, 00-1221, 00-1240, 00-1256, 01-1413, 01-1453, 01-1469, 01-1475, 02-1008, 02-1011, 02-1321.

Before: SENTELLE, ROGERS, and ROBERTS, *Circuit Judges*.

ORDER

Upon consideration of the petition for rehearing filed by petitioners-intervenors BP West Coast Products, et al., filed September 2, 2004, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:

Mark J. Langer, Clerk

BY: _____

Michael C. McGrail
Deputy Clerk

UNITED STATES COURT OF APPEALS,
DISTRICT OF COLUMBIA CIRCUIT

[Filed October 4, 2004]

No. 99-1020

BP WEST COAST PRODUCTS, LLC,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION AND
UNITED STATES OF AMERICA,
Respondents.

SFPP, L.P., ET AL.,
Intervenors.

CONSOLIDATED WITH 99-1051, 00-1221, 00-1240, 00-1256, 01-1413, 01-1453, 01-1469, 01-1475, 02-1008, 02-1011, 02-1321.

Before: SENTELLE, ROGERS, and ROBERTS, *Circuit Judges*.

ORDER

Upon consideration of petitioners-intervenors SFPP, LP's petition for rehearing filed September 3, 2004, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:

Mark J. Langer, Clerk

BY: _____

Michael C. McGrail
Deputy Clerk

APPENDIX D

Provisions of the Interstate Commerce Act

§ 1. Regulation in general; car service; alteration of line

(1) Carriers subject to regulation

The provisions of this chapter shall apply to common carriers engaged in—

* * *

(b) The transportation of oil or other commodity, except water and except natural or artificial gas, by pipe line, or partly by pipe line and partly by railroad or by water—

* * *

(3) Definitions

(a) The term "common carrier" as used in this chapter shall include all pipe-line companies; . . .

* * *

(5) Just and reasonable charges; applicability; criteria for determination

(a) All charges made for any service rendered or to be rendered in the transportation of passengers or property as aforesaid, or in connection therewith, shall be just and reasonable, and every unjust and unreasonable charge for such service or any part thereof is prohibited and declared to be unlawful . . . .

49 U.S.C. §§ 1(b), (3)(a), (5)(a) (1976).

§ 10. Violation of regulations by carrier; discrimination; penalties.

(1) Violation by carrier or officer, penalty.

Any common carrier subject to the provisions of this chapter, or, whenever such common carrier is a corporation, any director or officer thereof, or any receiver, trustees lessee, agent, or person acting for or employed by such corporation, who, alone or with any other corporation, company, person, or party, shall willfully do or cause to be done, or shall willingly suffer or permit to be done, any act, matter, or thing in this chapter prohibited or declared to be unlawful, or who shall aid or abet therein, or shall willfully omit or fail to do any act, matter, or thing in this chapter required to be done, or shall cause or willingly suffer or permit any act, matter, or thing so directed or required by this chapter to be done not to be so done, or shall aid or abet any such omission or failure, or shall be guilty of any infraction of this chapter for which no penalty is otherwise provided, or who shall aid or abet therein, shall be deemed guilty of a misdemeanor, and shall, upon conviction thereof in any district court of the United States within the jurisdiction of which such offense was committed, be subject to a fine of not to exceed $5,000 for each offense: *Provided*, That if the offense for which any person shall be convicted as aforesaid shall be an unlawful discrimination in rates, fares, or charges for the transportation of passengers or property, such person shall, in addition to the fine hereinbefore provided for, be liable to imprisonment in the penitentiary for a term of not exceeding two years, or both such fine and imprisonment, in the discretion of the court.

§ 13. Complaints to and investigations by Commission

(1) Complaint to Commission of violation of law by carrier; reparation; investigation

Any person, firm, corporation, company, or association, or any mercantile, agricultural, or manufacturing society or other organization, or any body politic or municipal organization, or any common carrier complaining of anything done or omitted to be done by any common carrier subject to the provisions of this chapter in contravention of the provisions thereof, may apply to said Commission by petition . . . . If such carrier or carriers shall not satisfy the complaint . . . , or there shall appear to be any reasonable ground for investigating said complaint, it shall be the duty of the Commission to investigate the matters complained of . . . .

(4) Duty of Commission where State regulations result in discrimination

Whenever in any such investigation the Commission, after full hearing, finds that any such rate, fare, charge, classification, regulation or practice causes any undue or unreasonable advantage, preference, or prejudice . . . , or unjust discrimination . . ., which is hereby forbidden and declared to be unlawful, it shall prescribe the rate, fare, ...

49 U.S.C. §§ 13(1), (4) (1976)

§ 15. Determination of rates, routes, etc.; routing of traffic; disclosures, etc.

(1) Commission empowered to determine and prescribe rates, classifications, etc.

Whenever, after full hearing, upon a complaint made as provided in section 13 of this Appendix, or after full hearing under an order for investigation and hearing made by the Commission on its own initiative, either in extension of any pending complaint or without any complaint whatever, the Commission shall be of opinion that any individual or joint rate, fare, or charge whatsoever demanded, charged, or collected by any common carrier or carriers subject to this chapter for the transportation of persons or property, as defined in section I of this Appendix, or that any individual or joint classification, regulation, or practice whatsoever of such carrier or carriers subject to the provisions of this chapter, is or will be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial, or otherwise in violation of any of the provisions of this chapter, the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable individual or joint rate, fare, or charge, or rates, fares, or charges, to be thereafter observed in such case, or the maximum or minimum, or maximum and minimum, to be charged, and what individual or joint classification, regulation, or practice is or will be just, fair, and reasonable, to be thereafter followed, and to make an order that the carrier or carriers shall cease and desist from such violation to the extent to which the Commission finds that the same does or will exist, and shall not thereafter publish, demand, or collect any rate, fare, or charge for such transportation other than the rate, fare, or charge so prescribed, or in excess of the maximum or less than the minimum so prescribed, as the case may be, and shall adopt the classification and shall conform to and observe the regulation or practice so prescribed.

(7) Commission to determine lawfulness of new rates; suspension; refunds; nonapplicability to common carriers by railroad subject to chapter

Whenever there shall be filed with the Commission any schedule stating a new individual or joint rate, fare, or charge, or any new individual or joint classification, or any new individual or joint regulation or practice affecting any rate, fare, or charge, the Commission shall have, and it is given, authority, either upon complaint or upon its own initiative without complaint, at once, and if it so orders without answer or other formal pleading by the interested carrier or carriers, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, fare, charge, classification, regulation, or practice; and pending such hearing and the decision thereon the Commission, upon filing with such schedule and delivering to the carrier or carriers affected thereby a statement in writing of its reasons for such suspension, may from time to time suspend the operation of such schedule and defer the use of such rate, fare, charge, classification, regulation, or practice, but not for a longer period than seven months beyond the time when it would otherwise go into effect; and after full hearing, whether completed before or after the rate, fare, charge, classification, regulation, or practice goes into effect, the Commission may make such order with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made within the period of suspension, the proposed change of rate, fare, charge, classification, regulation, or practice shall go into effect at the end of such period; but in case of a proposed increased rate or charge for or in respect to the transportation of property, the Commission may by order require the interested carrier or carriers to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require the in-

terested carrier or carriers to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a change in a rate, fare, charge, or classification, or in a rule, regulation, or practice, after September 18, 1940, the burden of proof shall be upon the carrier to show that the proposed changed rate, fare, charge, classification, rule, regulation, or practice is just and reasonable, and the Commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible. This paragraph shall not apply to common carriers by railroad subject to this chapter.

49 U.S.C. §§ 15(1), (7) (1976).

§ 16. Orders of Commission and enforcement thereof

(1) Award of damages

If, after hearing on a complaint made as provided in section 13 of this Appendix, the Commission shall determine that any party complainant is entitled to an award of damages under the provisions of this chapter for a violation thereof, the Commission shall make an order directing the carrier to pay to the complainant the sum to which he is entitled on or before a day named.

* * *

(3) Limitation of actions

(a) All actions at law by carriers subject to this chapter for recovery of their charges, or any part thereof, shall be begun within three years from the time the cause of action accrues, and not after.

(b) All complaints against carriers subject to this chapter for the recovery of damages not based on overcharges shall be filed with the Commission within two years from the time the cause of action accrues, ~~and not after, subject to~~ subdivision (d) of this paragraph.

(c) For recovery of overcharges action at law shall be begun or complaint filed with the Commission against carriers subject to this chapter within three years from the time the cause of action accrues, and not after, subject to subdivision (d) of this paragraph, except that if claim for the overcharge has been presented in writing to the carrier within the three-year period of limitation said period shall be extended to include six months from the time notice in writing is given by the carrier to the claimant of disallowance of the claim, or any part or parts thereof, specified in the notice.

(d) If on or before expiration of the two-year period of limitation in subdivision (b) of this paragraph or of the three-

year period of limitation in subdivision (c) of this paragraph a carrier subject to this chapter begins action under subdivision (a) of this paragraph for recovery of charges in respect of the same transportation service, or, without beginning action, collects charges in respect of that service, said period of limitation shall be extended to include ninety days from the time such action is begun or such charges are collected by the carrier.

(e) The cause of action in respect of a shipment of property shall, for the purposes of this section, be deemed to accrue upon delivery or tender of delivery thereof by the carrier, and not after.

(f) A complaint for the enforcement of an order of the Commission for the payment of money shall be filed in the district court or the State court within one year from the date of the order, and not after.

(g) The term "overcharges" as used in this section shall be deemed to mean charges for transportation services in excess of those applicable thereto under the tariffs lawfully on file with the Commission.

(h) The provisions of this paragraph shall extend to and embrace cases in which the cause of action accrued prior to June 7, 1924, as well as cases in which the cause of action accrues thereafter, except that actions at law begun or complaints filed with the Commission against carriers subject to this chapter for the recovery of overcharges where the cause of action accrued on or after March 1, 1920, shall not be deemed to be barred under subdivision (c) of this paragraph if such actions shall have been begun or complaints filed prior to June 7, 1924, or within six months thereafter.

(i) The provisions of this paragraph (3) shall extend to and embrace all transportation of property or passengers for or on behalf of the United States in connection with any action brought before the Commission or any court by or against

carriers subject to this chapter: *Provided, however,* That with respect to such transportation of property or passengers for or on behalf of the United States, the periods of limitation herein provided shall be extended to include three years from the date of (A) payment of charges for the transportation involved, or (B) subsequent refund for overpayment of such charges, or (C) deduction made under section 66 of this Appendix, whichever is later.